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## CONTENTS

Life Insurance and Inflation . . . . .	3
R. I. MEHR	
The Atomic Energy Commission's Developments Near Paducah . . . . .	11
ROBERT E. ROSE	
Economic Impact of the Joppa Power Plant on Southern Illinois . . . . .	16
J. R. BRODERICK	
The Development of Permissive Local Taxation Since 1945 .	20
RANDALL S. STOUT and EUGENE A. MYERS	
Have We Completed a Cycle of War Bond Selling? . . . .	36
DONALD L. KEMMERER	
An Analysis of Federal Budgets . . . . .	45
JOHN SAGAN, JR.	
Books Reviewed:	
<i>The Corporation Income Tax</i> , Goode	
<i>Trade and Agriculture</i> , Johnson	



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# Life Insurance and Inflation

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IS LIFE INSURANCE a good asset to hold during periods of inflation? This is a question which has provoked a great deal of discussion among investment counsellors, insurance men, and the investing public. It is a serious question especially among life insurance salesmen, because they must learn to answer it with a convincing "yes" or see a good part of their market fade away. Peddlers of stocks and other inflationary hedges might be inclined to answer the question in the negative. Although a categorical "yes" or "no" answer to this question would be desirable, it would be both impossible and unrealistic. Yet an unbiased answer is not difficult.

There is no question that inflation puts heavily into the values of life insurance just as it does into any other investment of a fixed dollar value. Therefore life insurance can be no investment hedge against inflation. But to say that, because of this, life insurance is a poor investment is very much like saying that a rose is a bad flower because it tastes so bad. Life insurance does not propose to be a hedge against inflation. It is purchased to hedge against premature death and old age. Persons seeking a hedge against inflation must look to other investment media. Life insurance does, however, serve as a good hedge against deflation.

## Life Insurance as a Hedge Against Premature Death

One of the major buying motives for life insurance is to obtain protection for

widows and children against the loss of family income resulting from the premature death of the breadwinner. The need for protection against premature death continues and is important irrespective of the inflationary cycle. Of course inflation can have a very real and serious effect on the value of life insurance protection. For example, it requires approximately \$44,000 of life insurance to provide a life income of \$150 a month for a widow aged 40. If the cost-of-living index rises to the point where it will take \$200 a month instead of \$150 to buy the bare necessities of life, the amount of life insurance required to maintain this level of income protection would be approximately \$59,000. Secular inflation means, therefore, that a man must continually buy more and more life insurance if he wishes to maintain the same real level of protection for his family. If the family income grows, as it will for many families during periods of prosperity, it should not work too great a hardship on the family to safeguard the value of its premature death protection by increasing the amount of life insurance in force on the life of the breadwinner. This, of course, assumes that the physical health of the insured is good enough to qualify him for more insurance.

It might be well to discount the possibility of inflation in advance by purchasing large amounts of term insurance. This protects the insurability of the breadwinner and also protects against the evil effects of any inflation

which occurs after the death of the insured. For example, if \$150 a month is needed for the beneficiary the insured can take \$59,000 of life insurance and use \$33,000 of it to provide a life income of \$110 a month for the beneficiary. The other \$26,000 can be left at interest with the insurance company and as such will pay \$40 a month. This will bring the total monthly income up to the desired \$150. The \$26,000 fund may be held as protection against inflation. It may be converted into a life annuity for the beneficiary whenever additional purchasing power is needed to maintain the pre-inflation purchasing power of \$150 a month.

For example, if prices should rise so that by the time the widow is age 45 it takes \$165 a month to maintain the purchasing power of the income, the additional \$15 a month can be provided by converting \$7,000 of the \$26,000 fund into a lifetime annuity.<sup>1</sup> If by the time the widow reaches age 55 inflation has continued so that \$215 a month is needed, the additional \$50 can be provided by converting the rest of the insurance into a life income. If the feared inflation never materializes, the \$26,000 fund can pass to the heirs of the beneficiary. The cost of this extra \$15,000 of life insurance would be slightly over \$150 a year on a term insurance plan issued at age 40, non-participating. It would cost about \$450 a year on a continuous-premium, ordinary life plan.

The effect of inflation on the value of

life insurance is much the same as its effect on the value of property insurance. For example, if inflation causes the value of a house to rise from \$15,000 to \$25,000, then the amount of fire insurance on that house should be increased from \$15,000 to \$25,000. Full protection of its value is to be maintained. Inflation similarly increases the value of human lives and demands more life insurance protection if these values are to be protected. As dollars become less valuable, it takes more of them to offer the same amount of real protection. Thus a man, just as with everything else, must pay more for his life insurance if he expects to maintain the same standard of protection.

The problem of maintaining constant protection against premature death in face of continuous inflation is not so difficult as it might appear at first glance. As the beneficiary advances in age, it will take less insurance to provide her a given life income. For example, although it takes \$44,000 of life insurance to provide a widow a life income of \$150 a month, starting at age 40, it would take only about \$37,000 of life insurance to provide this same life income for a widow starting at age 50. If the full \$44,000 of life insurance needed to provide a life income of \$150 a month for a widow age 40 does not mature but instead is left in force until the widow reaches age 50 (as when the insured does not die until his wife reaches age 50) the life insurance would have increased in income value to the widow from \$150 a month to \$185 a month. If the insured lives until his beneficiary is age 60, his \$44,000 of life insurance will

<sup>1</sup> The \$7,000 will pay about \$25 a month, but the net gain will be only \$15, since there will no longer be an interest income of \$10 a month from this fund. The interest income will decline to \$30 a month.



protect his widow to the extent of a life income of approximately \$195 a month. All these incomes are quoted on the basis of a 10-year certain guarantee and life thereafter. This rise in value offers very real protection against inflation so long as the policyholder lives.

The following tabulation is illustrative of the life income values of \$1,000 of life insurance proceeds at various ages of the beneficiary. The table shows how life insurance grows in income value as the beneficiary advances in age.

<i>Age of Beneficiary</i>	<i>Monthly Life Income per \$1,000 of Insurance Proceeds (10 years certain)</i>
<i>Female</i>	
35.....	\$3.18
40.....	3.39
45.....	3.64
50.....	3.95
55.....	4.32
60.....	4.79
65.....	5.35
70.....	6.01
75.....	6.76
80.....	7.54

What about protection for the beneficiary against inflation which may occur after the breadwinner has passed away? Suppose the insured dies when the widow is age 40. The \$44,000 of life insurance would provide her a life income of \$150 a month. If prices rise, the value of this income will fall. What can she do to offset this loss in value?

The answer is simple — nothing, unless there was additional insurance left at interest as insurance against inflation. But, for the following reasons, this is no indictment of life insurance!

In the first place, without the use of life insurance no fund as large as \$44,000 could have been accumulated for the widow over so short a period

of time. For example, assume that the husband and wife are both age 30 when the \$44,000 policy is purchased. The premium on this insurance at that age is about \$840 annually on a non-participating, continuous-premium, whole-life plan.<sup>2</sup> Over a 10-year period only \$8,400 would have been paid into the fund.<sup>3</sup> If the insured should die at the end of 10 years, the investment in life insurance would have grown over five times. It would take a tremendous rise in the value of stocks or real estate or a fantastic interest yield to produce this kind of increment through investments in other than life insurance contracts. Such a rise in value can offset inflation of the worst kind.

The fact that this increase in value can occur only by reason of the death of the policyholder is of no serious consequence, since it is assumed that the investment is made for the sole purpose of protecting dependent survivors. If the insured had lived to age 55 he would have paid premiums amounting to nearly \$21,000. The death benefit would more than double the value of this investment. If the insured lives to age 65, when the need for premature death protection subsides, he has contributed slightly over \$29,000 but he

<sup>2</sup> "Non-participating" means that no dividends are payable to policyholders. The continuous-premium, whole-life plan means that a level premium is paid each year while the insured is alive, and the face of the policy is payable upon the death of the insured, whenever that may occur.

<sup>3</sup> In the 10-year renewable term plan, the initial annual cost of the protection would be about \$420, non-participating. For the entire 10 years this would amount to only \$4,200. The term policy is payable only if death should occur within the term period.

has somewhat more than \$25,000 in cash values, assuming that he has purchased a continuous-premium, whole-life policy. This cash value of \$25,000 can be used to provide a retirement income.

The next question which arises is: What should the 40-year-old widow do with the \$44,000 of life insurance proceeds? If she takes a life-income settlement option, it will provide her with \$150 a month. This is equivalent to more than 4 percent on her money. Since the \$150 a month is a payment made by reason of death it is tax-free. This makes the 4 percent even more attractive than it appears at first glance. Of course, the cost of this relatively high return is the liquidation of the capital, but since the purpose of life insurance is to provide an income to care for the beneficiary there should be no concern over liquidating the principal amount. After all, the purpose of life insurance is not to leave the beneficiary capital to leave to someone else. What further use could a dead beneficiary make of her capital?

If the \$44,000 of insurance proceeds were invested in income-paying government securities, the beneficiary would have only about \$75 a month and this fund would be subject to income taxes. Of course, the beneficiary might find stocks with high yields which would provide some protection against inflation, but these types of investments are rather risky business. For the average widow, a *certain* \$150 a month at the expense of liquidating the capital might be more desirable than an *uncertain* \$150 a month, or more, derived from speculative securities although under this latter arrangement the capital

might remain intact. The widow might find that it is better to expose herself to the perils of inflation than to the uncertainties of speculative investment income. Of course, the ideal would be to have enough life insurance so that part of it could be used to hedge against deflation through an annuity income and the rest used to hedge against inflation through an investment in stocks and other equity properties.

### Life Insurance as a Hedge Against Old Age

Planning for financial security in old age is not easy today in face of high taxes, low interest yields, and inflationary trends. Therefore, it must be done early and systematically. Today's high taxes mean that a man can save less out of a given salary and investment income. Currently, a married man with one child who earns in the neighborhood of \$5,000 a year will pay an income tax of nearly \$550 annually. As his income increases, his tax burden rises sharply. A man does not have to be earning very much under the present income tax structure to find his marginal dollar taxed at the rate of say, 34 percent or even 38 percent.

Low interest rates mean that: (1) savings grow more slowly, and (2) larger amounts of capital are needed to pay a given income. At 2½ percent return, \$48,000 is necessary to pay \$100 a month. At the 6 percent that was available in Grandpa's time, a \$100 a month retirement income required only \$20,000 of capital — a sum much easier to save not only because it is a smaller amount but also because at the rates of compound interest available then, dollars grew much faster.



At 6 percent, a dollar doubles itself in less than 12 years; at  $2\frac{1}{2}$  percent it takes 28! The final effect is that over a 40-year working lifetime, savings of only about \$2.50 a week are required to provide \$100 a month at retirement if interest is at 6 percent compounded annually. At  $2\frac{1}{2}$  percent interest, savings of \$2.50 a week would yield only about \$18 a month. To provide \$100 a month would take savings of \$2.50 a day for a five-day week. Thus, a decline in interest from 6 percent to  $2\frac{1}{2}$  percent means that to provide a given retirement income a man must, over a 40-year working lifetime, save as much in a day as his grandfather had to save in a week! Not only are the dollars harder to save and accumulate today, but also it takes more of them to provide a given minimum standard of living.

How large a retirement income would Grandfather have been able to build for himself if he had just saved and invested a sum equivalent to the income taxes his grandson now has to pay? Assume that the amount of these taxes is \$550 annually, as indicated in the illustration. Assuming that Grandfather had saved this amount during his working lifetime (40 years) he would have been able to retire on over \$400 a month at age 65.

The result of the currently high taxes and low investment yields is that today virtually the only way many men can build a retirement income at age 65 is to liquidate their principal. Few men at 65 have enough capital to provide a livable income from interest alone. They must draw on capital. But the principal must be drawn on systematically so that it is not liquidated before

they are. Systematic liquidation, therefore, calls for the use of the annuity principle. Here a regular income is paid to the annuitant as long as he lives. Upon his death there may or may not be a refund, depending upon the type of annuity agreement made. The largest monthly income, of course, is derived from a straight life annuity, that is, an annuity which terminates upon the death of the annuitant without any refunds or guaranteed instalments.

In planning for life insurance needs, retirement can be left as one of the last considerations. This is the case because cash values of the policies designed to meet premature needs will take care of a good part of the needed old age income. For example, the \$44,000 of life insurance previously discussed will have a cash value at age 65 of slightly over \$25,000. This will provide a retirement income of somewhat more than \$150 a month for life, with 120 payments (\$18,000) guaranteed. In comparison, invested at 3 percent—a high rate for a safe investment—the \$25,000 will pay less than \$65 a month. If the \$25,000 fund had been built up through securities or investments other than life insurance, it could be used to purchase an annuity paying about \$140 a month (10 years certain). This is \$10 a month less than that provided by converting a similar amount of life insurance cash values into an annuity. The additional cost of annuities purchased with proceeds from outside investments arises from the additional cost of writing the policies, which includes an attractive commission for the agent. No agency commissions are paid when life insurance cash values are converted into annuities. A straight life annuity

**Monthly Incomes (120 months certain) at Age 65**  
(Non-participating; issued at age 25)

Rate per \$1,000 of face value	Type of policy	Cash value	Monthly income (per \$1,000 of insurance) which cash values will pay at 65, male
\$10.34	Term, to age 65	0	0
16.56	Continuous-premium, whole life	\$597	\$3.64
15.52	Life, paid up at 65	754	4.50
28.16	Twenty-pay life	754	4.50
21.76	Endowment at 65	1,000	6.06
30.79	Retirement income	1,664	10.00

without the 10-year guarantee would increase the monthly payments by about \$17 a month. The \$150 a month annuity payments when combined with social security benefits would yield an adequate retirement income. In addition, some families have the benefit of industrial pensions to fill out their retirement programs.

The amount of retirement income available from a life insurance policy depends upon the type of policy owned. For example, the accompanying table lists several policies. Compare their premium rates and the amount of life income their available cash values will pay, starting at age 65.

The rates indicate which policy should be selected in any given life insurance plan. The greater the relative need for more premature death protection, the lower should be the premium plan selected. For example, at age 25, a \$300 annual premium could purchase slightly over \$18,000 of premature death protection but only about \$65.50 old age income protection if purchased on an ordinary life basis. A \$300 annual premium spent for a retirement

income policy would provide only about \$10,000 premature death protection but about \$100 monthly retirement income. If the entire \$300 is used to purchase term insurance to age 65, it would buy about \$29,000 of premature death protection but no old age protection at all!

Some people prefer to accumulate retirement funds through investment media other than life insurance. Suppose a man age 65 has been able to accumulate \$50,000 in liquid assets which he now plans to use for retirement. He will have to invest it in a long-term, management-free, safe investment — a type of investment which generally produces a low yield. Invested at 3 percent (a liberal assumption) this fund would yield only \$125 a month. It is doubtful that a man who has earned enough during his working years to accumulate \$50,000 would be satisfied with only \$125 a month. If the \$50,000 were put into an immediate straight life annuity, it would pay him a monthly income of \$317 a month. An instalment refund annuity would pay him \$252 a month.

If the \$50,000 had been built up through life insurance, the settlement options of the policy could have been used to provide an even better income and the accumulation would have been made free of income tax. Fifty thousand dollars in cash values on a policy issued after October 1, 1942, will yield at age 65 about \$340 a month on a straight life basis. If the policy had been purchased between January 1, 1939, and October 1, 1942, the monthly income from it at age 65 would be about \$365 a month. On policies purchased between 1937 and 1939, the monthly income would be about \$385. The older policies have more favorable income options because they contain a more attractive interest guarantee and the benefits were computed on the basis of a shorter life. When interest assumptions were cut down from  $3\frac{1}{2}$  percent to 2 percent and more realistic mortality tables were adopted, the cost of annuities increased. If interest rates increase in the future, however, the holders of participating annuities will benefit by means of dividends.

One serious problem facing every married man who is planning for retirement is the matter of income for his wife if he predeceases her after he has passed retirement age. At least two solutions suggest themselves. One is the use of the joint-and-survivorship income option. This option promises to provide an income until the death of the last of the survivors — in this case, until both husband and wife are dead. The one disadvantage here is the low yield. Joint-and-survivorship income over \$1,000 of cash value for a male age 65 and a female age 62, for example, will run, in a typical company,

\$4.67 per month as contrasted to \$6.75 for the male alone. If the option stipulates that the life annuity shall be reduced to two-thirds at the first death, then the payments will rise from \$4.67 to \$5.46 per month during the lifetime of both annuitants and thereafter fall to \$3.64 during the lifetime of the survivor. Since two do not live as cheaply as one, it may thus be desirable to lower the income at the first death in order to get a more adequate income during the lives of both annuitants.

The second solution is to retain part of the life insurance in force, either on a premium-paying basis or as paid-up insurance. The method selected will depend on the amount of income for the amount of insurance available. Under this plan, at the death of the husband, the life insurance proceeds will continue the income for the wife.

In some instances, there will be life insurance on the wife which can be used to provide her with a retirement income in her own right that will continue regardless of the prior death of her husband. In the average family, however, the need for premature death protection of the breadwinner is such that it is rarely economically feasible to build a separate retirement income for the wife sufficient to cover her needs in the event that she outlives her husband.

The annuity makes it possible to provide a higher monthly income for retirement than can be made available through investments in securities of equal safety. This is done through the systematic liquidation of principal. The principal danger in the use of annuities is the exposure to loss of purchasing power through inflation. If it were pos-



sible to get a large enough safe income from the use of inflation-proof investments, then annuities and life insurance would be poor assets to hold when inflation is imminent. But in many

cases, for reasons presented in this article, life insurance and annuities are the *only* answer to the problem of hedging against premature death and old age.

# The Atomic Energy Commission's Developments Near Paducah

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ON DECEMBER 15, 1950, following the announcement of the H-bomb project in South Carolina, the Atomic Energy Commission disclosed the fact that the President's request of December 1 included funds for a new plant for the production of Uranium-235 by the gaseous diffusion process. The location for the plant was to be a site near Paducah. I doubt that we of the Commission are in a position to speculate with any authority on the probable impact of the plant on the area selected. Although we cannot prophesy as to the consequences of our new plant, we may give, within security limitations, information pertaining to the project itself, from which others may draw their own conclusions as to what it will mean to the Southern Illinois industrial area.

Businessmen and industrialists in the area may be particularly interested in knowing something of the reasons for selection of the site. They are no doubt interested in the basic purpose of the project, its anticipated size with respect to employment, as well as estimates of probable cost. The Atomic Energy Commission is, of course, an arm of the Federal government. Since that is true, the citizens of the area are not only interested in but entitled to know something of its operating policies and methods.

The plant now under way is situated on land formerly included in the Kentucky Ordnance Works area, some 16

miles west of the City of Paducah. The total project area now embraces some 7,300 acres, approximately 2,600 of which will ultimately be ceded to the Tennessee Valley Authority. The purpose of the plant is to augment the production of fissionable Uranium-235 by the gaseous diffusion process. It is essentially a duplicate of one of the plants at Oak Ridge, Tennessee.

Perhaps because Paducah is the home of one of our highest-ranking government officials, the matter of site selection seems to be of particular interest in this area. The administrative history leading up to the decision to build the new plant on the site of the old Kentucky Ordnance Works spanned a period of several months and involved the expenditure of considerable time and effort on the part of several government agencies. At the time the decision was made to build a new plant to increase production of fissionable materials, the Atomic Energy Commission requested the Department of Defense and the National Security Resources Board to assist in the selection of a suitable site. In the actual surveys and analyses which followed, other agencies lent assistance of great value. Because of the need for speed and economy the search was confined to tracts owned either wholly or partially by the government. Other major criteria were the apparent availability of labor, the accessibility of

large concentrations of power, and proximity to existing centers of population, so as to permit construction and operation of the plant without building new communities.

Actual sites surveyed for study numbered a score or more. Of these some were found to be unavailable because of other uses. Terrain of others was too rough for large-scale construction. Still others lacked accessible electric power. Selections were gradually weeded out until by September, 1950, the search had narrowed down to three probable sites. Of these the Kentucky Ordnance Works area appeared to offer the greatest number of advantages. The recommendation was turned over to a special committee which had been appointed for site selection of the H-bomb project in South Carolina. The committee unanimously approved the Paducah site.

Title to the site was in the Department of the Army and the land had been declared excess. Buildings and machinery were being maintained by the General Services Administration on a stand-by basis; and GSA had sold all but 1,400 of the original 15,000 acres. Acquisition of a portion of the additional land required was simplified by virtue of the fact that a repurchase clause in favor of the government had been inserted in each deed of sale.

Large quantities of electric power constitute a major requirement for operation of a gaseous diffusion plant. It was essential that fuel and water be available in such volume as to permit the development of large new power plants. Substantial amounts of power from existing sources must be available during the interim period before these

large steam plants could be in operation. The site selected meets both of these requirements. TVA's Kentucky Dam and the private utilities operating in the area offered assurance of adequate interim power. Fuel from the coal fields of Kentucky and Southern Illinois and water from the Ohio River seemed to be ample for the development of steam power facilities to meet the needs of the plant.

Prior to the announcement of the new plant the Commission commenced negotiations for both its long-term and short-term power needs. Originally, the Tennessee Valley Authority undertook to assure the Commission of all the power needed for the production facilities, if necessary. A number of private utility companies were approached by AEC. These contacts failed to develop acceptable proposals. The possibility was then explored of a combination of private companies which might supply all or part of the power required, and also provide interconnecting lines to take care of the need for interim power.

These negotiations resulted in a proposal from a combine of five private power companies in Southern Illinois, Kentucky, and Missouri to construct a power plant capable of meeting half of the project requirements. Under a contract with AEC the private power companies will install interconnecting lines, so that power excess to the needs of the project can be distributed back through the member systems; conversely, power excess to the utilities' needs will be available to the AEC during the interim period pending completion of the steam plant. The remaining half of the electric power will be furnished by TVA under the same sort



of contract provisions, with interconnecting lines back through its system.

The joint output of the new steam plants of TVA and the private power combine, known as Electric Energy, Incorporated, will approximate 1,250,000 kilowatts. The two steam plants are now under construction. That of the TVA adjoins the AEC plant area, and the Electric Energy plant is situated on the Illinois side of the Ohio River, just below the community of Joppa.

The AEC plant is expected to consume approximately 1,000,000 kw. It should be of particular interest to businessmen and industrialists in the area to note that there will be an apparent surplus of some 250,000 kw. In a comparative sense this amounts to approximately two-thirds of the total power output of Kentucky Utilities, and considerably more than the average annual output of Kentucky Dam.

It is conceivable that this tremendous concentration of power, reputed to be one of the largest in this country, will provide a strong attraction to industry to locate in this area. For this and other reasons, some have prophesied that this will become a center of industry in the fields of light metals and chemicals.

The AEC plant is being constructed by F. H. McGraw & Company of Hartford, Connecticut. Its prime construction contract for some \$330 million is said to be the largest single contract ever awarded by the government. Here again, as in the case of site selection, the McGraw Company was selected by means of a careful screening and analyzing process. More than a score of large construction organizations which had done work for the Commis-

sion at various times were considered. Obviously, the company selected for this tremendous and complex construction job must be one of considerable stature in the construction field. It must have and must have demonstrated the organizational know-how to develop and implement, in an extremely limited period of time, the complex administrative, engineering, and construction organization that the project demanded. The McGraw Company rated high in all of these considerations. Perhaps the most important factor of all was the necessity of selecting a company which not only had the know-how required, but had immediately available within its organization top-flight engineers and administrative men who could form the nucleus around which a construction organization could be built.

Actual construction at the site is now well under way. The anticipated employment peak is in the neighborhood of 12,000, which is expected to be attained in the latter part of this year. During the early stages of construction most of the personnel had been obtained from the local labor market. That is to say, it has been possible to obtain laborers and mechanics already living within commuting distance of the job. As the peak is approached, the manpower requirements will be predominantly for highly skilled men, particularly electricians and pipe fitters, who will have to be recruited from more highly industrialized areas. The expectation is that out of the total work force of some 12,000, perhaps 50 percent will be immigrants to this area.

Design work for the project is being done principally by three architect-engineer firms operating under prime

contracts with AEC, which are now on the project. Preliminary engineering and design of the plant and construction inspection are being performed by Giffels and Vallet, Incorporated, of Detroit. The firm of Sargent & Lundy, of Chicago, is concerned with design and inspection of construction of power facilities. The contract with Smith, Hinchman & Grylls, Inc., of Detroit, is for design and engineering for sanitary and fire water systems, sewer system, steam plant, and miscellaneous structures. It is interesting to note that these firms commenced work concurrently with the construction contractor, and have the extremely difficult job of developing and releasing drawings sufficiently ahead of the construction contractor so as not to impede the progress of the construction schedule.

Production facilities will be operated by the Carbide and Carbon Chemicals Company, a division of Union Carbide and Carbon Corporation. The company is now operating plants for the Atomic Energy Commission at Oak Ridge, Tennessee, and has acquired the technique and know-how necessary for maximum production efficiency at the Paducah plant. Carbide is also responsible for process design and procurement of special and critical equipment and materials. It is expected that total production employment at the plant will be in the neighborhood of 1,600. The operating contractor is manning the job concurrently with construction. Most of the top administrative and technical personnel will be transferred from Oak Ridge. Approximately half of the total production employment will be immigrants to this area from other

sections of the country; the remainder will be employed from local sources.

The production contractor is establishing schools for the training of production personnel. As individual buildings are completed at the site they will be immediately turned over to Carbide. The objective is the commencement of actual production operations immediately upon completion of the construction program.

The enumeration of these major companies, charged with the responsibility of designing, constructing, and operating the Atomic Energy plant at Paducah, should be of particular interest to business and industry in this area. It points up specifically and realistically a fundamental operating policy of the Atomic Energy Commission. The Commission itself is a government agency. In pursuance of the discharge of its responsibilities under the Atomic Energy Act, the Commission is striving to achieve its objectives in accordance with the private enterprise system of our country.

I believe that point is worthy of emphasis. We now have, actually, several thousand contracts with universities, research organizations, and industrial concerns, both large and small, for the conduct of virtually all phases of the atomic energy program. It might be questionable from a legalistic standpoint as to whether the Atomic Energy Commission, through this action, is departing, in a strict sense, from the authority granted by the Congress. Be that as it may, private enterprise is being relied upon to an increasingly larger extent to carry on the development and application of atomic energy in its various aspects. To the fullest

extent permissible under national security regulations, the Commission has encouraged the participation of private enterprise and has made scientific and technical information available for its use.

This philosophy is being applied as well in matters indirectly relating to the expansion program. As might be surmised, we have encountered a number of very real problems not directly connected with our project, but nevertheless exercising an important influence in prosecuting the construction and operation of the plant. The immigrant employees for both construction and operation must be housed; schools must be provided; and community facilities and services must be available. The Commission has the authority under the Atomic Energy Act to take such action as is necessary to meet these problems. Here again, however, we prefer to look to private enterprise. We have encouraged the development by private capital of temporary housing and trailer parks for construction employees. We have lent our assistance and support in developing measures to stimulate private home construction. We have attempted, in the fullest possible measure, to assist the local communities in finding solutions to their problems having to do with expansion of utilities and services—water and sewer systems, roads and streets, police and fire protection, public health, hospitals, schools, and others.

In a relative sense the Paducah plant will not be a particularly large enterprise. The maximum permanent employment is expected to be about 1,600. Probably half of this number will be newcomers to this area. As compared with other industries in Southern Illinois and Kentucky, this is not, in and of itself, sufficiently large to create any great industrial impact. Of far more importance, it seems to me, is that which might be reasonably expected to result from the location of the plant in this area.

The potentials of atomic energy and its impact on our economic and social structure are immeasurable at this time. I think that I may say that it is a source of much misgiving to many of those affiliated with the atomic energy program today that its primary purpose is, and apparently must remain for an indeterminate period of time, the research, development, and production of the materials and weapons of war. Even so, the by-products and the related research in the field of atomic energy have already made deep and lasting impressions. The most noteworthy is the use of radioisotopes in medicine, biology, agriculture, and industry, which holds a promise of ultimate benefit to mankind that is fantastic to comprehend. It is our fervent hope and prayer that the day may come when all of our energies may be directed to that end.



# Economic Impact of the Joppa Power Plant on Southern Illinois

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THE ECONOMIC IMPACT on the economy of Southern Illinois of the new power plant now being constructed by Electric Energy, Inc., will no doubt be appreciable. Electric Energy, Inc., is a company formed for the purpose of constructing and operating this power plant and is owned by five electric utilities now located in the area. These companies are Union Electric Company of Missouri, Central Illinois Public Service Company, Illinois Power Company, Kentucky Utilities Company, and Middle South Utilities Company.

Electric Energy, Inc., therefore should be considered as a local concern, for it is owned by local companies and its property is in our own back yard. This company was formed on very short notice because of the emergency and considerable red tape and negotiations were dispensed with, a fact which clearly proves that private business can, when called upon, perform just about any task demanded of it. These five utility companies are now interconnected through their present transmission systems, and will provide the electric service necessary for construction of the plant. After the plant is placed in operation these interconnected systems can provide emergency capacity to the plant when this is necessary. In like manner, should there be any spare or surplus capacity above the firm commitments of the plant, this energy will be made available to the

transmission systems of the five utility companies. After the installation of the original designed capacity, should it be deemed advisable at any future time to install additional capacity for the needs of these five utility systems, this can be done. The original plant cost is estimated to be \$90,000,000.

A brief description of the plant may bring home to the reader its immense size and capacity.

The coal-handling facilities, the coal storage area, the sub-station yard, and the barge-handling facilities are shown in some detail in the architect's drawings. A large tower is provided to carry a double circuit across the Ohio River which will convey energy to the atomic energy plant. Supplying this power is, of course, the immediate occasion for the plant's construction.

The plant will be located about 1¼ miles down the Ohio River, or west of Joppa, a town of approximately 750 people. It will consist of four steam turbo generators, each with a capability of 163,000 kw. The turbines are as large as or larger than any machines so far developed for one shaft. They will be of the outdoor type. This is thought to be the farthest point north where this type of turbine has been installed.

There will be four outdoor-type boilers, one for each turbine, each of which will have a capacity of 1,200,000 pounds of water per hour. In other words, they will be able to evaporate approximately 145,000 gallons an hour.

Each boiler will be as high as a 14-story building and will be approximately 50 feet long and 85 feet wide. The entire capacity of these four units will deliver approximately 650,000 kw. at the bus bars.

The fuel for firing the boilers will be powdered coal, and the annual requirements will approximate  $2\frac{1}{2}$  million tons. This is some 7,000 tons per day and is larger than the capacity of most of the single mines in Southern Illinois. Only one or two mines in this area produce so much coal a day at peak capacity.

Now let us see what  $2\frac{1}{2}$  million tons of coal a year means to the community of Southern Illinois. No doubt much benefit will be derived by all who are connected with the coal industry, which in this area means practically everyone. Using an average of  $11\frac{1}{2}$  tons per man-day as a fair average of production and \$17.50 per day as an average wage for the miner, this  $2\frac{1}{2}$  million tons per year will mean almost \$4 million in wages each year, or about \$333,000 a month. This is therefore a very direct benefit to the area economy and will result immediately when the plant is in full operation, which is expected to be within two years.

Now let us assume for this discussion that all of the coal will be hauled by rail. If that is the case and a \$1.32 freight rate is assumed, the railroads will receive \$3,300,000 per year, or \$275,000 per month, for this freight service. To ship this coal will require 55,000 railroad cars. The handling of this business will require 500 railroad employees at an average daily wage of \$12.58. The total payroll will be \$151,250 per month, or \$1,815,000 per year.

Now let us examine the benefits of the wages paid for the construction and later for the operation of this plant.

It is estimated that at the peak of construction 2,000 people will be engaged in the work. These people during this period will be paid approximately \$800,000 a month in wages and salaries. This personnel will consist of engineers, draftsmen, accountants, clerks, superintendents, inspectors, all types of building craftsmen, janitors, Republicans, Democrats, and no doubt some of other political beliefs. All races and creeds will be in evidence to bring this engineers' dream to a fulfillment.

A large part of these wages and salaries will find its way into the business established in the community, at the plant site as well as in the surrounding territory, and will make a real contribution to the economic welfare of the area.

When the plant is in operation approximately 200 people will be permanently employed in its operation. This type of employee will be a substantial citizen, usually a married man with a family. If we say, however, that 80 percent will be married, and use the Bureau of Labor Statistics average figure of 3.69 members to the family, the permanent community population increase will be approximately 630 people. Therefore school facilities for an additional 270 children must be provided, and 160 homes must be available for housing these families. There will be additional churches, stores, shops, filling stations, recreation locations, utility facilities, and so on required to serve them.

These new citizens of the community will receive in salaries and wages approximately \$1 million a year, or \$90,000 a month. Practically all of this will be spent with merchants, businesses, and utilities, such as telephone, transportation, water and electric service, located in the area.

Individual businessmen are no doubt concerned with how this will affect their particular business. While the results can not be exactly and completely calculated, Bureau of Labor Statistics estimates may be used as to how such workers spend their incomes. These figures, shown in Table 1, ex-

**Table 1. Estimated Expenditures of Work Force During Peak of Construction of the Plant**

Item	Percent of \$800,000	Expenditure per month
Food.....	26.00	\$208,000
Clothing.....	14.00	112,000
Housing.....	12.40	99,200
Household operation.....	3.77	30,160
Furnishings and equipment.....	3.00	24,000
Automobiles.....	4.00	32,000
Other transportation.....	1.90	15,200
Medical care.....	4.30	34,400
Personal care.....	1.90	15,200
Recreation.....	2.38	19,040
Tobacco.....	1.61	12,880
Reading matter...	0.84	6,720
Formal education..	0.66	5,280
Other.....	1.00	8,000

clude taxes, life and other insurance, and savings.

Now let us see how these figures apply to the income from salaries and wages received during normal operation of the plant. You will recall that

I mentioned an anticipated payroll of \$90,000 a month, or \$1,080,000 a year. Again applying the Bureau of Labor Statistics percentages, the resulting figures are perhaps more important as a gauge of the normal economic effect on the area. Table 2 shows these estimates for the same items as those listed in Table 1.

The entire coal area will indirectly benefit through the expenditures made from the estimated \$4 million in wages paid to coal miners for the production of the 2½ million tons of coal consumed by the plant. For purposes of this comparison a total of approximately four times the amount calculated for the permanent employees of the plant will be spent in the Southern Illinois area. For food, as an example, this will mean about \$1,150,000 per year; for clothing \$600,000 per year; for housing \$530,000 per year; and for furnishings and equipment \$130,000 per year.

There will be many additional dollars spent for construction materials such as hardware, trucks, lumber, pipe, concrete, etc., which will be purchased within the area, but it is not possible to make an intelligent guess as to the amount of such purchases. These dollars will also find their way directly into the economy of Southern Illinois.

Too, there will be many operating supplies purchased in the area after the plant is in operation, the amount depending upon the availability.

Perhaps the most important benefit to the economy of the area through the building and operation of this plant is that it will be a tax-producing enterprise rather than a tax-consuming one. Thus schools, municipalities, and other



Table 2. Estimated Expenditures of Work Force Based on Normal Average Yearly Payroll

Item	Percent of \$1,080,000	Expenditure	
		Per year	Per month
Food.....	26.00	\$280,800	\$23,400
Clothing.....	14.00	151,200	12,600
Housing.....	12.40	133,920	11,160
Household operation.....	3.77	40,716	3,393
Furnishings and equipment.....	3.00	32,400	2,700
Automobiles.....	4.00	43,200	3,600
Other transportation.....	1.90	20,520	1,710
Medical care.....	4.30	46,440	3,870
Personal care.....	1.90	20,520	1,710
Recreation.....	2.38	25,704	2,142
Tobacco.....	1.61	17,388	1,449
Reading matter.....	0.84	9,072	756
Formal education.....	0.66	7,128	594
Other.....	1.00	10,800	900

local civic services which depend for their existence on taxpayers, both citizens and corporations, will be benefited.

The basic facts presented may be of help to Southern Illinois business and professional men in deciding possible changes in their own operations. Need-

less to say, these are not definite conclusions, as many other factors must be included before the final appraisal, such as the extent of our defense effort, the extension of the present Korean conflict, and other such vital matters.

**Editor's note:** The two preceding articles are adapted from addresses delivered at a Businessmen's Conference held at Southern Illinois University, Carbondale, on June 14, 1951.

The purpose of the Conference was

to provide background information concerning the Atomic Energy Commission's projects in the Southern Illinois industrial area and to discuss their probable economic impact.

W. M. C.

# The Development of Permissive Local Taxation Since 1945

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SINCE 1945 the outstanding trend in the development of state-local fiscal relations has been the enactment of permissive local tax legislation, enabling municipalities to levy non-property taxes on an unprecedented scale. As a matter of fact, certain local governments in over half of the states have been empowered to levy one or more non-property taxes. Local governments, by means of permissive tax legislation, now tax practically everything from cats to personal incomes, from bicycles to public utilities, from amusement devices to business receipts, from shuffle boards to hotel room occupancy, from consumers' utility bills to cigarettes, cigars, and chewing tobacco, and from dealers in wooden legs to dealers in sliced watermelon.

Although the property tax is still the backbone of the local tax system, non-property taxes, generated by permissive tax legislation, are rapidly becoming more important in the tax collections of local revenue systems. Non-property tax yields were \$348 million in 1942 compared with \$851 million in 1949, or an increase of 144 percent. The property tax collections in the same period increased 54 percent. Non-property tax collections are even

more important in the nation's 397 largest cities of over 25,000 population; whereas non-property tax collections in these cities between the years 1942 and 1948 increased 134 percent, property tax collections increased only 22 percent. It should be further noted that property tax yields in 1942 constituted 60.7 percent of total local tax collections, compared with 52.7 percent in 1949. Non-property tax collections, on the other hand, increased from 13.7 percent in 1942 to 17.1 percent in 1949.

The purpose of the discussion herein is to set forth the more important legislation concerning the use of permissive local taxes in several selected states since 1947, to summarize the recommendations of several state legislative committees regarding the use of such taxes, and to evaluate the development of permissive local taxation in the light of current trends in public finance.

## Permissive Local Tax Legislation in Selected States

PENNSYLVANIA. Pennsylvania broadened the taxing powers of its local governments in unprecedented fashion in 1947 with the enactment of Act Number 481. This highly controversial Act permitted 3,588 municipalities to levy taxes on six broad bases, namely: persons, transactions, occupations, privileges, subjects, and personal property. The Act is applicable to 2nd, 2nd A,

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and 3rd class cities; boroughs; towns; first class townships; and school districts of the 2nd, 3rd and 4th classes. All counties and second class (rural) townships are outside the scope of the Act, as are the City of Philadelphia and school districts of Philadelphia and Pittsburgh. Supplemental local taxing powers were authorized for Philadelphia under legislation enacted in 1932 and for the school districts of Philadelphia and Pittsburgh by legislation in 1947.

Several important features of the Act should be noted. First, strict adherence to the principle of separation of revenue sources is followed; thus, municipalities may not impose taxes on bases now taxed at the State level. The Act furthermore prohibits the levy of taxes on gross receipts from utility service companies subject to regulation by the Public Utility Commission. It also sets a limit on the aggregate of revenues obtained under Act 481 levies by requiring that the Act 481 levies cannot exceed the maximum permissible yield on real estate subject to taxation within the respective jurisdictions. As the Act was originally written, there were no limits upon tax rates, but limits were imposed under 1949 amendments. It is also worthy of note that the collection of taxes under the Act is provided on the local level only, and municipalities have full discretion in the matter of establishing appropriate regulations concerning the collection process. By the end of 1950, Act 481 levies had been imposed by approximately 1,025 municipalities in the State.

The following tabulation indicates these levies, as of January 1, 1951, by types of taxes:

<i>Types of taxes</i>	<i>Number of municipalities using tax</i>
Per capita taxes.....	506
Income and wage taxes....	230
Amusement taxes.....	260
Mercantile licenses.....	48
Mechanical devices.....	104
Deed transfer taxes.....	75
Occupational taxes.....	21
Trailer taxes.....	21
Taxes on signs and billboards	9
Taxes on employers.....	7
Miscellaneous types.....	21
Total.....	1,302

Source: Pennsylvania Department of Internal Affairs, *Taxes Levied Under Act 481*, January 31, 1951.

A breakdown of the number of municipalities using these levies, by type of jurisdiction, indicates that they were in use by 710 school districts, 251 boroughs, 41 cities, and 23 first class townships.

For the first time since the enactment of Act 481, nearly four years ago, data are available indicating the yield from the various levies. These data are presented in Table 1. Total collections for the year 1949 were approximately \$23,500,000, including levies by school districts. It should be pointed out that this tabulation does not include permissive levies imposed by the City of Philadelphia, under separate legislation. The most productive of the Act 481 levies are income and wage taxes, mercantile and business taxes, amusement taxes, and per capita taxes.<sup>1</sup>

The first two years of operation under the Act occasioned many disputes

<sup>1</sup> For an excellent discussion of the operation of the Act see: "Act 481; Its First Two Years of Operation," *Bulletin*, Pennsylvania Department of Internal Affairs, February, 1950; Elizabeth Smedley, "Legal Problems Involving Act 481," Second Edition, Pennsylvania Department of Internal Affairs, 1950.

Table 1. Total Receipts from Act 481 Levies in Pennsylvania, 1949

Type of tax	Cities, 2nd and 2nd A classes	Cities, 3rd class	Boroughs	Town- ships, 1st class	School districts, 1949-50	Total
Amusement . . . . .	\$1,603,848	\$1,700,604	\$ 855,766	\$138,735	\$ 655,545	\$4,298,954
Deed transfer . . . . .		8,038	8,220	207,478	362,285	223,736
Income . . . . .	1,138,348	4,216,075	1,060,102	13,190	3,673,347	6,427,715
Mechanical devices . . . . .		31,054	51,575	2,640	1,868	85,269
Mercantile and busi- ness licenses . . . . .	2,738,448	1,552,272	127,425		152,231	4,418,145
Per capita . . . . .		119,415	470,180	13,212	1,277,447	602,807
Personal property . . . . .	676,039	46,642	5,063		80,847	727,744
Occupation . . . . .					123,562	
Severance . . . . .			14,811	18,894	74,737	33,705
Others . . . . .			53,114	409	164,718	53,523
All types . . . . .	\$6,156,683	\$7,674,100	\$2,646,256	\$394,559	\$6,566,587	\$16,871,598

Source: Pennsylvania Department of Internal Affairs, *Taxes Levied Under Act 481*, January 31, 1951.

Note: School district totals are not included in total column, since school year does not coincide with calendar year.

and dissatisfaction in some quarters. The Legislature directed its Tax Study Committee to investigate the operation of the levies and to make recommendations concerning the Act. The Committee analyzed the early operations of the Act as follows:

A review of the operations of Act 481 reveals a number of unfortunate consequences. The first of these is the problem resulting from the overlapping territorial boundaries. Act 481 gives tax preference to the political subdivisions of the taxpayer's residence by providing that the taxpayer can deduct from similar tax liabilities imposed elsewhere, the taxes paid to the political subdivision wherein he resides. Under a recent decision (Lackawanna County Common Pleas No. 11, Sept. term, 1948) coterminous municipalities and school districts may levy the same tax. The provisions have complicated employer compliance by requiring the employer to withhold and return to a number of jurisdictions the taxes due on wage and salary disbursements. Disputes between local governments over priority

to the right to tax and overlapping of tax jurisdictions have met with some public disapproval. There is ample justification for the enactment of amendments which at least will limit permissive taxation to one level of government.

The variety and complexity of some of the taxes which have been enacted has provoked just criticism of Act 481 . . . the local revenue structure of Pennsylvania has been complicated by new taxes. Local political subdivisions have created many new collection mechanisms, some of doubtful efficiency. Taxpayer cost of compliance with local taxing laws has increased and taxpayers face considerable uncertainty as to the type and rate of tax which may be imposed at any time by local governments. . . .

Even now levies have been enacted which place certain business enterprises at economic disadvantage. Without restrictive amendments, the situation may be expected to become more serious. Under less favorable economic conditions, the present authority of permissive taxation may well be used to establish "protected" economic areas which restrict the free flow of goods within the Commonwealth.



Act 481 should be amended to eliminate the objectionable consequences of its operation, and to prohibit the levying of taxes which may impair the productive processes of the Commonwealth. The principle of permissive local taxation should be retained in Pennsylvania, but its application limited to specified taxes at specified maximum rates. Permissive taxation should be made available to only one level of government, namely cities, towns, boroughs, and first class townships. The authority of these municipalities to tax non-residents employed within their jurisdiction should be removed. These amendments would eliminate the imposition of taxes on the same taxable by more than one political subdivision, simplify the tax structures, and reduce taxpayer uncertainties.<sup>2</sup>

In 1949 the General Assembly removed a number of the objectionable features of the Act by amendments.<sup>3</sup> The previous exemption of gross receipts from utility services was broadened to include services rendered by a public utility. The aggregate revenues from Act 481 levies were limited to 10 mills on assessed valuations for municipalities other than school districts; aggregate revenues from Act 481 levies for school districts were limited to 15 mills on assessed valuations. A procedure was set up to prevent expenditure of revenues in excess of those permitted under limitations in the Act; it is probable, however, that the application of this procedure will be somewhat difficult. The taxation of the income of non-residents of school districts by school districts was prohibited on the theory that non-residents receive no direct benefits from school facilities.

This restriction will affect approximately 138 school districts which levied income and wage taxes in 1949.

Another important exemption provided in the Amendment applies to manufactured goods, farm products, and natural resources, including the prohibition of taxes on privileges, acts, or transactions relating to manufacturing, production, or processing of natural resources or farm goods. Taxes on personal properties (intangibles) were prohibited where such properties are subject to the county personal property tax (except in cities of the second class and Pittsburgh).

The Amendment further imposed rate limitations on specific taxes, as follows:

- (1) Per capita taxes — \$10
- (2) Mercantile taxes — 1.5 mills on retailers and 1 mill on wholesalers, except in the City of Pittsburgh, where the limit is 2 mills on retailers and 1 mill on wholesalers
- (3) Wages, salaries, commissions, and other earned income — 1%
- (4) Retail sales — 2%
- (5) Sales involving transfer of title to real property — 1%
- (6) Amusement taxes — 10%

The Amendment also provided that municipalities must file copies of their tax ordinances or resolutions with the Department of Internal Affairs. Joint action by municipalities in setting up collection machinery was also permitted by the Amendment.

NEW YORK. New York has approached the problem of additional revenue for municipalities from several directions. The forerunner of recent legislation

<sup>2</sup> Pennsylvania Joint State Government Commission, *Report of the Tax Study Committee*, Part II, February, 1949, p. 7ff.

<sup>3</sup> Act No. 246, P.L. 898, 1949.

was a Constitutional Amendment, Art. VII, Section 17, approved November 2, 1943, which authorized the Legislature to create "funds to aid in the stabilization of the tax revenues of the State available for expenditure or distribution." After careful study of state-local fiscal needs by the Moore Commission,<sup>4</sup> the Legislature enacted a series of laws which provided increased financial aid for municipalities by means of:

- (A) a Local Assistance Budget and a Local Assistance Reserve Fund;<sup>5</sup>
- (B) a system of annual per capita state grants in the amount of \$6.75, \$3.55, and \$3.00 to cities, towns, and villages, respectively;<sup>6</sup>
- (C) a system of permissive local taxes.<sup>7</sup>

The permissive local tax legislation permitted New York City, counties, and cities to levy specific taxes at specific rates. Under the original Act, counties were restricted in their use of taxes in that they were required to distribute proceeds to school districts; the Amendments in 1948 eliminated this restriction. The amendments further extended to counties the privilege of levying a business gross-receipts tax and a hotel room occupancy tax. The original Act granted permissive taxing

powers to cities having a population of over 100,000; the 1948 Amendments extended this power to cities having a population of over 25,000. In 1950 the Legislature extended to smaller cities the power to impose specified non-property taxes by local option. Villages of over 5,000 population were permitted the use of a 1 percent tax on the gross income of utilities. The Legislature also extended until 1955 the authorization of local taxes on racing, but provided that the rate be no higher than 1 percent by 1955. It is significant that the legislation of 1948 authorized counties and cities to enter into regional agreements for joint imposition and administration of the permissive taxes. The State Tax Commission was directed to prepare model local laws, ordinances, and regulations, and is empowered to cooperate with municipalities toward the end of effectuating uniform administration.

#### *Present Status and Fiscal Importance of Permissive Taxes in New York*

The types of permissive local taxes levied in New York as of 1950 are set forth in Table 2, which excludes New York City. The yield of these taxes for fiscal periods ended in 1949 for municipalities in New York is indicated by statistics in Table 3.

Few local governments in New York have taken advantage of these permissive taxes — only two counties and five cities have used them. Erie County was the first taxing jurisdiction to enter the field with a 1 percent retail sales and use tax effective July 1, 1947; Monroe County followed with a general-business gross-receipts tax of 3/10 of 1 per-

<sup>4</sup> State of New York, *Report of the Commission on Municipal Revenues and Reduction of Real Estate Taxes*, 1945.

<sup>5</sup> Laws of New York, Chap. 303, 1946.

<sup>6</sup> Laws of New York, Chap. 301, 1946.

<sup>7</sup> Laws of New York, Chap. 278, 1947; Chap. 651, 1948.

See also, *Annual Reports of the New York State Tax Commission*, 1946-47; 1947-48.

Table 2. Types of Non-Property Taxes Levied by New York Municipalities  
(Excluding New York City)

Unit	Authorized for	Item taxed	Maximum rate
Counties	County purposes	Pari-mutuel pools except at harness race meetings	5%
Counties	Education purposes, and for allocation to cities, possibly as direct payments, and the area outside cities for reduction of the county tax on real estate	All taxes listed below for cities of more than 25,000 but less than 1,000,000	(See a-i below)
Cities	General purposes	Gross income of utilities subject to the state utilities tax	1%
Cities of more than 25,000 but less than 1,000,000 to the extent not imposed by the county in which the city is situated	General purposes	(a) Retail sales of tangible personal property including gas, electricity, steam, and refrigeration; and compensating use of tangible personal property	2%
		(b) Restaurant charges of \$1.00 or more	3%
		(c) Consumers' utility bills	3%
		(d) Privilege of selling liquor, wine, or beer at retail for on- or off-premises consumption	25% of State license fee
		(e) Admissions, certain dues or membership fees and cabaret charges	5%
		(f) Coin-operated amusement devices	\$25 per annum
		(g) Motor vehicles: Lighter non-commercial passenger vehicles	\$5.00
		Heavier passenger vehicles and trucks	\$10.00
		(h) Privilege of doing business General businesses	3/10 of 1% of gross receipts
		Financial businesses	3/5 of 1% on gross income
		(i) Hotel room occupancy	5%

Source: State of New York, *Comptroller's Committee Report on Local Non-Property Taxes*, March 6, 1950.

cent (3/5 of 1 percent on gross income of financial businesses). A 2 percent retail sales and use tax was adopted by Syracuse in 1948, and by Poughkeepsie in 1949, but the Syracuse tax has been reduced to 1 percent. Troy has been

levying a 3 percent tax on utility bills since January, 1949; and since February, 1949, Binghamton has been levying a 5 percent tax on admissions, a 5 percent tax on hotels, a motor vehicle use tax of \$5 on passenger cars and

Table 3. New York State: Receipts of Local Non-Property Taxes  
During Local Fiscal or Collection Periods Ended in 1949

Tax imposed on	Municipality	Rate	Receipts	
			Each municipality	Total
Admissions. . . . .	Binghamton	5%	\$ 69,060	\$ 69,060
Conduit companies. . . . .	New York City	3%	494,330	494,330
Consumers' utility bills. . . . .	Binghamton	3%	83,838	153,463
	Troy	3%	69,625	
Business and financial. . . . .	Monroe County	3/10 and 3/5 of 1%	3,942,155	68,051,693
	New York City	2/10 and 2/5 of 1%	64,109,538	
Hotel room occupancy. . . . .	Binghamton	5%	23,283	4,560,839
	New York City	5%	4,537,556	
Motor vehicle use. . . . .	Binghamton	\$5 and \$10	108,837	108,837
Occupancy and vending machines (public housing purposes). . . . .	New York City	10¢ to \$6	748,608	748,608
Pari-mutuel pools. . . . .	Nassau County	5%	3,253,993	15,762,496
	New York City	5%	11,677,799	
	Saratoga County	5%	830,704	
Sales and compensating use	Erie County	1%	6,567,664	146,432,284
	New York City	2%	137,273,602	
	Poughkeepsie	2%	484,882	
	Syracuse	2% and 1%	2,106,136	
Utility. . . . .	New York City	1% and 3%	8,109,068	10,487,004
	60 upstate cities	1%	2,377,936	
Total, all taxes. . . . .				\$246,868,614
New York City. . . . .				\$226,950,501
All other municipalities. . . . .				\$19,918,113

Source: State of New York, *Comptroller's Committee Report on Local Non-Property Taxes*, March 6, 1950.

\$10 on trucks, and a 3 percent consumers' utility tax. A 2 percent sales and use tax became effective in Newburgh on April 1, 1950.

Perhaps the most significant recent development in New York is the Constitutional Amendment (Article VIII, Section 10) effective January 1, 1950, which requires the use of *full valuation assessments* instead of actual debased

assessments for purposes of constitutional tax rate limitations.<sup>8</sup> Counties, cities, villages, and school districts must use the 5-year average of full valuations in computing tax rate limitations. It is important to note that this Constitutional Amendment does not confer any additional taxing pow-

<sup>8</sup> Memorandum, New York State Department of Audit and Control, Oct. 19, 1950.



ers on municipalities as compared with their taxing powers under the original tax limits of 1884. It is merely another attempt to enforce existing legislation, but with greatly improved techniques (such as the determination of equalization ratios for each political subdivision by the State Board of Equalization and Assessment). In addition to prescribing the use of 5-year average full valuations, the Amendment sets tax rate limits for counties, cities, villages, and school districts. The Amendment is significant in relation to municipal finances because:<sup>9</sup>

(A) The change to *full valuation assessments* as the tax limit base will provide a *uniform base* for tax limits without requiring any change in the level at which real estate in any municipality is being assessed locally.

(B) The use of a full valuation base will not interfere with, or control, the assessed valuations of individual parcels of property.

(C) The use of full valuation as the base for tax limits will eliminate among municipalities artificial variations in taxing power resulting from variations in the rate of assessment, and, at the same time, will provide uniform protection to real estate against excessive taxation.

(D) Use of full valuation of taxable real property as the base for the tax limit will give greater importance to the equalization rates established by the State.

(E) The movement toward full val-

uation as a tax base will, *in effect*, provide municipalities with additional revenues from the property tax, without any increase in the tax *rates*.<sup>10</sup>

FLORIDA. Florida cities and towns are authorized to levy consumers' sales taxes on utility services such as electricity, metered or bottled gas (natural, liquefied petroleum gas, or manufactured), water service, telephone service, and telegraph service.<sup>11</sup> The rate of tax may not exceed 10 percent of the retail price of the utility services, but the rate may be on a straight-percentage, sliding-scale, graduated, or other basis. The Act specifies that the incidence of the tax shall be on the consumer of the services, but that the sellers must act as collecting agents for the cities or towns. The ordinances may provide for the exemption of utility sales made by a government unit; in the event that any ordinance imposes a tax on the sales of a utility service taxable under the Act, and a competitive utility service is sold in the city or town, then the tax ordinance shall impose a tax in like amount on the sale of the competitive utility service, whether privately or publicly owned or distributed; however, telephone service and telegraph service shall not be required to be considered competitive services. The Municipal Finance Officers Association reported that more than 25 cities in Florida were using consumers' utility sales taxes in 1947.

Florida further increased the taxing powers of its cities in 1949 by author-

<sup>9</sup> State of New York, *Second Report of the Comptroller's Committee on Constitutional Tax and Debt Limitations and City-School Fiscal Relations*, March 30, 1949, p. 12ff.

<sup>10</sup> See: State of New York, *Report of the State Comptroller's Committee on Local Non-Property Taxes*, March 6, 1950.

<sup>11</sup> Section 167.43-1, (1947) Cumulative Supplement to Florida Statutes, 1941.

izing them to levy a tax on cigarettes at the rate of 5 cents per package. This tax must be collected by the State and refunded to the cities, less the costs of collection. In order to qualify, the cities must adopt an ordinance and make annual reports to the State. It is significant that the Act provides that one-half of the increased revenue received from this tax must be used to reduce the property tax levies. At the same time, legislation was enacted prohibiting municipalities from levying admissions taxes. The cities which had admissions taxes under previous legislation, however, were permitted to retain them.

MARYLAND. Maryland in 1947 enacted legislation permitting cities and towns, as well as counties, to levy admissions taxes in addition to those imposed by the State.<sup>12</sup> The tax may be imposed upon the gross receipts of all types of amusements and sports (except those devoted exclusively to charitable, religious or educational purposes, or where the proceeds are for volunteer fire companies) at a prescribed rate of one-half percent. The counties may impose such taxes on amusements and sports, provided they are not carried on within the boundaries of any incorporated city or town. Individual proprietorships and corporations are taxable under the Act. The State Comptroller is designated as the collecting agent, and is required to remit the net proceeds of the tax to the cities, towns, and counties quarterly. Another Act<sup>13</sup> specified that incorporated cities, towns, and counties should receive all net proceeds from certain

business licenses on business conducted within the particular jurisdiction, after the deduction of a collection fee by the county clerk and a further 3 percent of license revenues to be paid into the General Fund of the State to defray the expenses of the State License Bureau.

Under the enabling Act of 1947<sup>14</sup> the City of Baltimore enacted a series of six tax ordinances for the purpose of obtaining additional revenues for the period 1948 to 1951, inclusive. The ordinances provide for the following additional taxes:

(1) A 3 percent gross-receipts tax on the Baltimore Transit Company and the Baltimore Coach Company; an additional tax of 10 percent of the consolidated net income of the above companies.

(Ordinance No. 122, December 26, 1947)

(2) A 5 percent consumers' sales tax on the sale of artificial or natural gas, electricity, and telephone services delivered in or originating within the limits of Baltimore City.

(Ordinance No. 108, December 17, 1947)

(3) A 3 percent gross-receipts tax on persons, firms, or corporations operating public passenger motor vehicles in the City of Baltimore.

(Ordinance No. 121, December 26, 1947)

(4) A tax of 50 cents per gallon on all distilled spirits and other alcoholic beverages, except beer and wine, sold or delivered by a manufacturer or wholesaler to any retailer in Baltimore. The regulations provide that the manufacturer or wholesaler shall be permitted to deduct 11 percent of the gross amount of tax due as compensation for collecting the tax.

(Ordinance No. 107, December 17, 1947)

(5) Taxes on tobacco products, as follows:

Cigarettes — 1 cent for each 20 cigarettes.

Cigars selling for: less than 7 cents each, no tax; 7 cents to 15 cents each,

<sup>12</sup> Laws of Maryland, Chap. 601, 1947.

<sup>13</sup> Laws of Maryland, Chap. 487, 1947.

<sup>14</sup> Laws of Maryland, Chap. 1, 1947.

1 cent tax; 15 cents to 30 cents each, 2 cents tax; more than 30 cents each, 3 cents tax.

Smoking tobacco—1 cent tax on each 20 cents of retail selling price.

Chewing tobacco—1 cent tax on each 20 cents of retail selling price.

(Ordinance No. 106, December 17, 1947)

(6) Annual license taxes on the operation of coin-operated musical and amusement devices, according to the following schedule:

Mechanical musical devices—\$10 each.

Pinball machines—\$65 each.

Console pinball machines—\$100 each.

Shuffle boards—\$25 each.

Arcade operating 15 or more pinball machines—\$1,000 per establishment.

The above license taxes are applicable to persons, firms, associations, and corporations.

(Ordinance No. 105, December 17, 1947)

In 1949 the Legislature extended a loan amounting to \$70 million to the counties for the construction of new school buildings.<sup>15</sup> Under the same enabling Act the Legislature directed the county commissioners of each county to levy a property tax at the rate of 4.2 cents on each \$100 property valuation for the years 1950 and 1951 and 21 cents on each \$100 valuation beginning with 1952. This levy is to be in effect until the loans are repaid.

CALIFORNIA. Municipal sales taxes are the outstanding permissive local taxes in this State. There is no enabling act specifically permitting cities to levy general sales taxes; the cities possess this taxing power as a result of general powers of taxation. As of January 1, 1951, 141 cities having 56 percent of the total population of California

and 70 percent of all outlets licensed under the State sales tax were levying local sales taxes. The municipal sales taxes are in addition to the State sales tax, which is imposed at a rate of 3 percent. Most cities have a sales tax at the rate of  $\frac{1}{2}$  of 1 percent, but 29 cities use a 1 percent rate. During the fiscal year ended June 30, 1950, collections from these municipal sales taxes amounted to \$31,500,000, or in excess of 10 percent of total local collections in these cities. It is estimated that the yield may exceed \$40,000,000 in the current fiscal period, 1950-51.<sup>16</sup>

Several major problems plague the use of municipal sales taxes in this State. There is no uniformity with respect to the municipal sales tax acts, bases, regulations, reports, and procedures. In addition, there are legal and constitutional obstacles in the way of integration of the municipal levies with the State levy. Another problem involves the existence of tax-free areas in the State, creating competitive differentials so far as business and consumers are concerned.

The California State Board of Equalization has summarized the significant trends with respect to municipal sales taxes as follows:

These changes indicate that cities are going to rely on sales tax revenues in one form or another for the indefinite future and probably to do so in increasing degree. Few now believe that city sales taxes in California are a passing phenomenon that

<sup>16</sup> See California State Board of Equalization, *What's Next in Local Sales Taxes*, January, 1951; *City Sales Taxes in California*, February, 1948.

Also see: University of California, Bureau of Governmental Research, *Administration of Municipal Sales Taxes in California*, December, 1949.

<sup>15</sup> Laws of Maryland, Chap. 488, 1949.

will become a matter of historical interest only once the cities have adjusted to the postwar scene. The time seems to have come, therefore, for re-examination of the problems which arose when cities invaded a field of taxation traditionally reserved for the State.

Such a re-examination will reveal that some means of integrating the administration of state and local sales taxes is needed in the interests of the cities and the taxpayers. Taxpayers need to be relieved of the cost of complying with more than 140 different sales taxes and the annoyance of duplicate or even multiple audits. Cities need to be relieved of the cost of administering these taxes with the type of audit program that will assure a satisfactory degree of compliance.<sup>17</sup>

OHIO. The State of Ohio was forced to consider local revenues when the State Supreme Court invalidated the consumers' utility tax levied by the City of Youngstown and certain other cities. The State adopted a middle-of-the-road policy of increasing local taxing powers, combined with larger grants-in-aid. The Legislature repealed the State tax on admissions and amusements, and that left the field open to the municipalities. To date, 79 cities have enacted admissions taxes. With the exception of three cities, all have imposed a rate of 3 percent. Using minimum rates, the Tax Commissioner has estimated that these cities will collect a total of over \$2,000,000 per year from this source, which is considered satisfactory. The Commissioner recommended a more efficient administration of the personal property tax, which he estimated would yield \$5,000,000 more per year for localities.

<sup>17</sup> California Board of Equalization, *What's Next in Local Sales Taxes*, January, 1951, p. 23.

No further action has been taken relating to permissive taxation in Ohio.

ILLINOIS. The Illinois Legislature in Senate Bill 631 (1947) permitted cities and villages to enact sales taxes at a rate of one-half of 1 percent by means of referendum; the local sales taxes must be administered by the State Department of Revenue, and the State must refund the proceeds to localities. East St. Louis conducted a referendum in April, 1948, and the proposition was defeated. Officials in Illinois believe there will be little use of local sales taxes in Illinois in the near future, in spite of the fact that the State has had a sales tax on the State level for a period of fifteen years. It is important to note that no local sales taxes have been enacted thus far.

OTHER STATES. The list of states permitting new local taxes grew in 1949 and 1950. Mississippi authorized its twelve largest cities to levy a sales tax, after a local referendum, at 25 percent of the State rate. The tax must be administered by the State Tax Department. Thus far, only four cities have taken advantage of this authorization.

Louisiana passed a measure permitting all cities to levy a 1 percent sales tax; this privilege, prior to the 1950 Act, was limited to New Orleans only. As a result of recent legislation in Tennessee, the cities are now permitted to levy a 2 percent gross-receipts tax on theaters. An amendment to the business license law in Arizona broadened the application of this law in such manner as to provide a greater annual yield from the tax. Municipalities in Minnesota were authorized to levy assessments for the purpose of financing



certain highway improvements. Towns and cities in North Dakota were permitted to levy a property tax not to exceed 4 mills per dollar of assessed valuation to finance airports. Instead of financing improvements by special assessments, Colorado passed permissive legislation calling for a levy of a general tax for this purpose. Nebraska increased the occupation tax for city and village purposes, which had been authorized by previous legislation. In the matter of further financial assistance to municipalities, eight states in 1949 adopted new tax-sharing methods and thirteen states increased municipalities' shares of taxes already being returned locally.

### Recommendations of Legislative Committees Concerning Permissive Local Taxation

Within the past three years legislative committees have been at work in a number of states surveying the fiscal needs of municipalities. The recommendations of a few of these committees are briefly discussed herein in order to indicate the present attitudes of these legislative agencies with respect to the future development of permissive local taxation.

TENNESSEE. The Tennessee Tax Revision Commission recently recommended three changes in its State tax structure which would directly benefit local governments.<sup>18</sup> The first recommendation urged that the State relinquish to the local governments the general property tax, which is now levied at a rate of 8 cents per \$100

of assessed valuation; this would provide local governments with \$1.5 million annually in additional revenues. The Commission specifically suggested that the local governments use these property taxes for school purposes or else reduce their own property tax levies by 8 cents in the event that the additional revenue is not necessary. The second recommendation urged the State to repeal its tax on amusements and to permit cities with over 5,000 population, and all counties, to enact an amusement tax applicable to all commercial amusements, not to exceed 5 percent of their gross receipts from admissions, on approval of such levy by the voters of the local jurisdiction by referendum. It was estimated that local governments would derive about \$800,000 annually from such a tax. It was further recommended that the 5 percent rate might be moderately increased in the event of Federal withdrawal from the amusement tax field. The third and most important recommendation was directed toward the immediate improvement of the method of distributing the State sales tax "overage," that is, the amount over the first \$20,000,000 collected. Present methods were criticized as inequitable, unsound, and wasteful.

VIRGINIA. In Virginia a legislative Commission<sup>19</sup> recommended improvements in the administration of the property tax designed to increase local revenues; in addition, it recommended additional taxing powers for municipalities. Re-

<sup>18</sup> Tennessee Tax Revision Commission, Report, November, 1948, p. 11ff.

<sup>19</sup> Commonwealth of Virginia, *Report of the Commission on State and Local Revenues and Expenditures*, 1949.

garding property taxation, the following recommendations were made:

(1) Reassess real estate in both counties and cities on a quadrennial basis.

(2) Improve assessment of tangible personal properties.

The Commission recommended that the municipalities be permitted to retain the revenues derived from the following sources, now used by the State:

(1) Proceeds of taxes on deeds, wills, suits, and contracts.

(2) Marriage licenses.

(3) Excess fees.

The following additional revenue sources were recommended for counties and municipalities; in those instances in which a county and a town located therein both levy the same tax, the proceeds from the levy should be divided equally between the county and the town:

(1) An admissions tax not to exceed 10 percent.

(2) A motor license tax not to exceed the State rate in those counties and municipalities which have street or highway responsibilities.

(3) A hotel occupancy tax not to exceed 5 percent of room rentals.

(4) A business and occupational license tax which shall be limited to objects taxed by the State and to the State rates.

(5) A utility consumers' tax at a standard rate of 5 percent.

GEORGIA. The Georgia Tax Revision Committee made two important recom-

mendations which would increase local revenues:<sup>20</sup>

(1) Gradually reduce the State tax rate on general property from the present 5 mill rate to 1½ mills.

(2) Repeal all license and privilege taxes (levied for revenue only) on the State level, thus leaving these sources available for municipalities.

ALABAMA. The Alabama Revenue Survey Commission recommended State tax changes similar to those in Georgia; its recommendations were as follows:<sup>21</sup>

(1) Repeal all State levies on general property; this would shift about \$6 million from State to local users.

(2) Relinquish State privilege license taxes and make them available for local use; this change would provide about \$744,000 annually in additional local revenues.

It is worthy of note that the Commission recommended certain principles and procedures for municipalities to follow in levying business privilege taxes; these were as follows:

(1) Business privileges should be classified into a limited number of groups.

(2) The basis of classification should be the type of business or its organization, not the commodities dealt in.

(3) Local units may be authorized to levy a few selective sales taxes, such as admissions taxes and taxes on tobacco and beer, but these should be viewed as commodity excises and not as privilege license taxes.

(4) With these exceptions, no busi-

<sup>20</sup> Report of the Georgia Tax Revision Committee, January, 1950.

<sup>21</sup> Report of the Alabama Revenue Survey Commission, January, 1947.

ness establishment should be required to pay more than one privilege tax.

(5) The measure of all basic privilege taxes should be confined to some significant business index such as gross or net receipts, investment, number of employees, or number of units.

(6) All flat sum or specific levies that do not vary directly and proportionately with a significant business measurement should be prohibited.

(7) The payment of a license should be made as convenient as possible. In no instance should a local unit be permitted to levy a heavy tax on a new establishment as a prerequisite to starting in business.

(8) All such taxes should be moderate. They should not be so high as to constitute a serious impediment either to starting a new enterprise or to continuing in business.

ILLINOIS. The Illinois Revenue Laws Commission has recommended additional financial aid for school districts and increased property tax rates for cities and villages.<sup>22</sup> The proposal involves a state grant to school districts in the amount of \$25,000,000, which is in addition to the regular school grants. This grant is termed a "property tax reduction grant"; county clerks are to reduce extendible school tax levies by the amount of this grant. On the other hand, the maximum tax rate limits of cities and villages would be increased to permit the levy of additional taxes equivalent to the amounts by which the school taxes were reduced. This proposal means that cities and villages in need of more revenues could

obtain them without any additional over-all tax increase on property. The Commission recommended that regular school districts should maintain a property tax levy of 0.4 percent and unit school districts a property tax rate of 0.6 percent in order to participate in the additional school grants.

NEW YORK. New York has continued the study of the operation of its permissive local taxes, and a Committee headed by Comptroller Frank C. Moore has had problems relating to these taxes under consideration.<sup>23</sup> A number of recommendations were submitted to the Legislature in the spring of 1950. It was recommended that counties be permitted to impose for county purposes the non-property taxes which they now collect for allocation to school districts and cities. This would enable counties to obtain additional revenues for their own needs. It was also recommended that cities of less than 25,000 population be permitted to levy non-property taxes like those now levied by larger cities. The Committee suggested that villages of over 5,000 population be permitted to levy the 1 percent tax on gross income of utilities. In addition, the Committee recommended that villages be permitted to share in the proceeds of certain county-collected taxes.

NEW JERSEY. The New Jersey Commission on State Tax Policy<sup>24</sup> looks with favor upon additional taxing powers for municipalities in that State. Its

<sup>22</sup> State of New York, *Report of the State Comptroller's Committee on Local Non-Property Taxes*, March 6, 1950.

<sup>24</sup> State of New Jersey, "Taxation and Public Policy in New Jersey," *Report of the Commission on State Tax Policy*, April, 1950.

<sup>23</sup> Illinois Revenue Laws Commission, *Report*, 1949, p. 18.

recommendations with respect to tax principles were as follows:

If more tax moneys are absolutely necessary to support municipal services, and the real estate tax is inadequate for that purpose, it is preferable for municipalities to resort to their own taxing authority rather than to look to the State for grants of any kind. To follow such a policy, it would be necessary for the State to delegate taxing powers to the municipalities which would enable them effectively to balance their budgets from sources other than the real estate tax but also suitable for local administration. To follow such a policy it would be necessary:

(1) To authorize counties and municipalities to levy, assess and collect such taxes as are suitable for local administration—for example, a consumers' tax (sales), luxury taxes, or gross business taxes; or

(2) To authorize counties and municipalities to levy supplementary rates upon such State tax as may otherwise be selected for State purposes. This would mean State administration with a return to the municipality of the yield of the supplemental rate. Since the State does not now levy any tax suitable for permissive local supplement or overlay, the first alternative is the only one presently available.

### Summary

A. Permissive local taxes provide additional revenues for municipalities, give some relief to property taxpayers, and bring about some necessary diversification in the local revenue structure.

B. At present, the following conclusions may be made with respect to permissive local taxation:

(1) The most significant permissive local tax legislation since 1945 has been enacted in New York and Pennsylvania; activity with respect to use of

such taxes is concentrated in a few states, particularly New York, Pennsylvania, California, and Maryland.

- (2) The principal types of permissive local levies are wage and income taxes, amusement taxes, special business licenses, and selected excises.
- (3) There is renewed interest in the integration of state and local revenue systems, in view of the existence of sales-tax-free areas, absence of uniformity in local tax laws and regulations, and lack of adequate local audits.
- (4) Some permissive local taxes, like those in Pennsylvania, are tied with limitations based on property assessments; this emphasizes the fact that assessments are still the key factor in the local revenue structure.
- (5) In most states the legislatures have specifically prescribed the tax bases and rates to be used by municipalities.

C. In considering permissive local taxes, careful attention should be given to the types of taxes permitted in order to avoid some undesirable consequences, such as:

- (1) The complication of local revenue structures.
- (2) Overlapping taxation.
- (3) Duplication of tax collection machinery, resulting in increased costs of tax collection.
- (4) Increases in costs of taxpayer compliance through a multiplicity of reports and procedures.
- (5) Punitive taxes, placing certain



industries at a decided economic disadvantage.

(6) Use of taxes which are entirely unrelated to the ability of industries to pay such taxes.

(7) Use of varying rates of taxation which tend to create competitive differentials for industries operating in many geographic areas.

D. In order to achieve reasonable equity in local taxation and in order to bring about long overdue coordination in state-local revenue systems, the following are suggested:

(1) Use of uniform ordinances and uniform reporting procedures for all municipalities.

(2) The legislature should prescribe specific types of taxes which may be levied for local purposes, and at the same time it should prescribe the limits for such taxes.

(3) Where local excises are imposed upon the same bases which are used for state purposes, such as cigarette taxes or

general sales taxes, it seems desirable that the state should collect such taxes and remit the local share of the proceeds which comes from the local levies.

(4) The types of taxes levied should bear some reasonable relation to the economic capacity of the taxpayers, such as the amount of income or gross receipts of the business; the "number of employees" for example, bears no direct relation to the amount of business net income, turnover of inventories, value of products, or investments in plants and facilities.

(5) Where municipal income taxes are employed, the legislature should define the concept of taxable income, rather than leave this important job to thousands of municipalities, in order to prevent serious differences in tax bases as between different municipalities.

# Have We Completed a Cycle of War Bond Selling?

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MOST OF US are perfectionists on at least some matters. For centuries man has constantly sought new ways of worshipping, governing, playing games, running his economy, regulating his money supply, raising children, building fighting ships, and so on, ad infinitum. No way is ever perfect and yet we keep hoping that the next experiment will reveal the perfect way. It never does. We make some improvements, it is true, and we may find a method that is better adapted to a changed condition. Light armored ships, for example, have speed but offer little protection; heavy armored ones sacrifice speed but offer more protection. Each has its advantages and disadvantages; no one has all the advantages.

Likewise, no economic or political or other system of doing things is perfect, because man himself is not perfect and never will be. Yet, somehow, many of us persist in thinking that the kind of economy, the type of money system, or some other course of action, that we are not using is better than the one that we are using. The faults of any system in use are painfully appar-

ent; the virtues of any proposed system tend to be glamorized. Those who remember the faults it had the last time it was used have died. So we try a different system. This idealism or optimism, too often untempered by experience or knowledge of history, is one of the mainsprings of change. It explains why history keeps repeating itself. It explains why, for example, people have tired of government regulation and tried *laissez faire*, and then tired of that and tried government regulation again. Or why people shift back and forth between hard money systems and soft or managed money systems. What has this philosophizing to do with war bond sales? Quite a lot, as you will see, if you read on.

There are three basic ways of financing a modern war: namely, by taxation, by borrowing (selling bonds), and by creating money (and bank deposits). They are desirable and painful, both, in the order just given. In major modern wars all three methods are bound to be used. The middle method, selling bonds, generally provides more funds than either of the other two. (See Table 1, Column 4.) The terms

Table 1. Financing Three Major American Wars

War	Duration in months	Cost in billions	Percentage of cost paid by		
			Taxes	Bonds	Money creation
Civil War.....	48	\$ 4	18	70	12
World War I.....	19	26	20	50	30
World War II.....	45	330	40	50	10

Table 2. Major Bond Issues in the Civil War

Authorized in	Interest rate	Term in years	Proceeds in millions
July-August, 1861.....	6	20	\$189.2
February, 1862.....	6	5-20	514.7
March, 1863.....	6	17	74.3
March, 1864.....	5	10-40	172.9
June, 1864.....	6	5-20	90.7
Total, 1861-64.....	5-6	5-40	\$1,041.8

Source: D. R. Dewey, *Financial History of the United States* (1928), pp. 306-8.

of bond sales differ, however, from one major war to the next. The faults of the old method are remembered and hopes are held for a better method this time. Let us examine the methods used in this country, starting with the Civil War, our first modern war, and continuing down to the present. The Civil War method, especially, should interest us today.

### Civil War Bonds

The Civil War was a struggle between an industrially strong but militarily weak North and an industrially weak but militarily strong South. At the start the North was recklessly optimistic of victory. The first 75,000 troops were mustered in for just three months and Congress increased taxes only slightly. But the North won no major battles for over a year and a half, and as the war went on and on costs mounted. Soon the banks showed a reluctance to lend more to the government on any but very stiff terms. The people of that era were not accustomed to buying government bonds as they are nowadays. So the Treasury floated a \$50 million loan in the form of short-term notes that circulated as money. It was these notes that forced a sus-

pension of specie payments in December, 1861, and drove the country off the gold standard. Subsequently other issues of Treasury notes, called "greenbacks," caused more inflation.

During the war the government also conducted five major bond drives. (See Table 2.) This was in addition to the sale of a welter of short-term Treasury notes. Jay Cooke, an astute and energetic Philadelphia banker, organized a corps of salesmen who almost literally peddled bonds from door to door. All told, 70 percent of the war was financed by borrowing. It was necessary to make these bonds very attractive to sell them. They usually carried interest of 6 percent. Better yet, the buyer could pay for them in greenbacks but was promised in most cases that the interest and principal he received would be gold. This was an especially fine bargain for those who bought bonds when the greenbacks were heavily depreciated. It was the high price paid by a government whose credit was not very good. Professor Wesley C. Mitchell later estimated that the use of greenbacks in the Civil War increased the cost of the war by \$600 million.

After the war was over there was

Table 3. World War I Bond Issues

Loan	Date	Interest rate	Term in years	Proceeds in millions
First Liberty.....	April, 1917	3.5	15-30	\$1,989
Second Liberty.....	October, 1917	4.0	10-25	3,808
Third Liberty.....	April, 1918	4.25	10	4,176
Fourth Liberty.....	September, 1918	4.25	15-20	6,964
Victory.....	May, 1919	4.75	2-3	4,498
Total.....	1917-19	3.5-4.75	2-30	\$21,435

Source: D. R. Dewey, *Financial History of the United States* (1928), pp. 502-3, 506, 508, 516.

considerable resentment towards those bondholders who insisted too legalistically on their pound of gold flesh. The later bond issues had not stated clearly, as had the earlier ones, that they were payable in gold. Despite political campaigns featuring such slogans as "The same currency for the bondholder and the plowholder," all the bondholders were paid off in gold. This costly way of financing the war and its political repercussions were long remembered, however, and influenced the financing of World War I.

### World War I Bonds

Although we had over two years' warning that we might be drawn into World War I, we were ill prepared when the time came. We had to train troops and produce supplies for them and get them all to Europe in a hurry. This was bound to be costly. As before, we increased taxes reluctantly and this had effects that might have been expected on our price level and on our monetary system. Prices rose sharply. We prohibited the export of gold in 1917 and thus abandoned the gold standard. This time, however, the government issued no greenbacks. The in-

flation that took place was largely the result of increased demand deposits. The increase of these grew in part out of the sale of bonds to banks, in part out of sales to bank customers who were assisted by somewhat indefinite loans, and in part from other causes, such as war-induced business expansion. It is difficult to ascertain very accurately how much of the war was financed by the creation of such bank credit. Selling bonds to banks in exchange for created deposits is money creation just as is printing greenbacks. A reasonable estimate on World War I money creation is 30 percent.

Approximately half the direct cost of the war was met by genuine borrowing. There were four major bond sales during World War I and one victory loan of three-year Treasury notes afterwards. (See Table 3.) In addition, there were, of course, continual sales of various short-term Treasury obligations. Neither the principal nor the interest of these bonds was payable in gold, but the interest rate ranged from 3.5 percent to 4.75 percent. People were urged to save through bonds so that after the war they might buy what they wanted.



Although we returned to a gold standard in June of 1919 and wholesale prices fell 40 percent in 1920-21, the bonds got an undesirable reputation after the war. Too many persons wanted to cash in their bonds in a market that was not strong anyway. Fourth Liberty Loan bonds sold as low as 82. Perhaps this was the best remembered fact about World War I Liberty Bonds. Obviously it was something to be avoided, if possible, the next time.

### World War II Bonds

World War II was a double war and it lasted over twice as long as World War I. Despite at least two years of warning, we were again caught unprepared. Because of a decade of depression, moreover, our public debt was already sizable (\$43 billion in 1940). But the banking and fiscal policy pursued since 1931 had driven interest rates to an all-time low. This made loanable funds cheap not only to the government but also to everyone else and stimulated inflation. Again there were no greenback issues, however. The nation was on a "qualified" gold standard and had no difficulty remaining on it. Since there was no domestic convertibility of gold, specie payments did not have to be suspended. With other nations' currencies more inflated than ours, we could continue to redeem gold internationally although most of the time it was not necessary to do so. As in previous wars, tax increases were slow in appearing.

Bond sales again provided much of the funds, especially at first. A summary of the eight war loan drives in the *Federal Reserve Bulletin* for Feb-

ruary, 1946 (p. 120) shows the amounts sold as follows:

<i>Issue</i>	<i>Total sales in millions</i>
First War Loan.....	\$ 12,947
Second War Loan.....	18,555
Third War Loan.....	18,944
Fourth War Loan.....	16,730
Fifth War Loan.....	20,639
Sixth War Loan.....	21,621
Seventh War Loan.....	26,313
Victory Loan.....	21,144
Total, eight loans.....	\$156,893

The amounts raised in these drives include not only bonds, however, but billions of dollars in short-term Treasury obligations also. As in World War I, a large part of these bonds were at first sold to or through banks. After 1942 strenuous efforts were made to sell more of them to the public. This was not especially successful but the effort was highly commendable. The banks continued to take a large part of the government bonds, but in a more indirect way now. Thanks chiefly to increased production over the nation, less of this war was financed by creating money and bank credit (about 10 percent) than of World War I.

One peculiar feature of World War II securities was that all issues of the same term had the same interest rates. This was the famous wartime "Pattern of Rates," shown in the following tabulation:

<i>Issue</i>	<i>Interest rate</i>
90-day Treasury bills.....	.375
1-year Treasury certificates....	.875
8- to 10-year bonds.....	2.000
Long-term bonds.....	2.500

Each bond drive was not characterized by a higher rate than the previous one as was usually the case in World

War I. The highest rate of all was 2.9 percent on the E or savings bonds when held to their 10-year maturity. From the Treasury's viewpoint this consistently low pattern of rates kept down the service cost of government securities.

As in World War I, people were urged to save by buying bonds. It was even hinted that spending these savings after the war would prevent a depression. Partly to remove any fear of not being able to market the bonds favorably, as had been the case in 1920-22, the price was virtually guaranteed. That was essential too to maintain the "pattern of rates." It was done by the cooperation of the Federal Reserve System. The New York Federal Reserve Bank bought the securities at pegged prices if there were no other buyers. This pegging of government security prices was probably the most conspicuous feature of World War II securities. It was also their worst. And this pegging continued after the war and was still practiced as late as early 1951. True, the pattern of rates was allowed to rise somewhat.

Federal Reserve Bank support-purchases of government securities pumped bank credit into circulation just at the time when some of it should have been drawn off. When the price level rose, that put pressure on interest rates to rise. That forced security prices down, which in turn obliged the Federal Reserve to buy more government securities to protect the government security price level that the Treasury wanted maintained. And that put more demand deposits into circulation and paved the way for a second round of the same process. The process was so

subtle, however, that most laymen did not understand it.

Only a combination of circumstances in the winter of 1950-51 finally broke the vicious circle. The price level rose as much as one percent a month during the latter part of 1950. This greatly disturbed the American public and Congress. The feeling grew that something would have to be done to stop the inflation. Newspapers gave the public some idea of the cause. The Board of Governors of the Federal Reserve System finally came to believe that the time was propitious for taking action. A \$3 billion budgetary surplus made the Treasury less resistant. Still, both the Treasury and the President protested a rise in interest rates and a removal of the bond "pegs." These protests served to highlight the controversy. On March 3 an agreement to remove the pegs on bonds was announced. Since then bond prices have fallen and interest rates have risen. Actually, that is two ways of saying the same thing. All this reflects an improved situation for the time being. But is it sufficiently improved and how long will it remain improved?

The Korean War may be nearing a settlement. The Iranian incident may not prove so serious as at first appeared. But Russia is very likely to create other situations. Therefore the big armament program must go ahead. It will really get under way this autumn. Meanwhile the membership of the present seven-man Board of Governors of the Federal Reserve System which mustered the courage to raise interest rates is due for further changes. Marriner Eccles has resigned, M. S. Szymczak is contemplating re-

signing, and one or even two others may also depart. It seems probable that President Truman will appoint men more sympathetic with the Treasury view. There is also considerable re-financing to do this year. Either it must be all on a short-term basis, which solves little, or the Federal Reserve must temporarily "make a market" for the longer issues. Sooner or later there must be some longer issues. Can we be sure that the market that is then "made" is only temporarily "made"? We might readily find ourselves back on a long-term bond-support basis, with the only difference that bond prices are lower and interest rates higher. That is the background against which World War III or the big armament must be financed. It is still an explosive situation.

### Present-Day Bonds

Three generations have been born and many persons have lived out their lives and died since the Civil War. Once again a great industrial nation that is militarily weak is pitted against a great agricultural nation that is militarily strong. Again our financial health is not good. Taxes are high; local, state and Federal taxes take almost 30 percent of the national income. This tax rate right now, before any large-scale hostilities, is as high as it was on the average over World War II. It is above the rate (25%) which the Australian tax expert, Colin Clark, contends curbs incentives to work and leads to inflation.

People still have vivid memories of the OPA price controls and of the World War II inflation. They are sophisticated about price controls. They

want no more inflation, but they fear that there will be more.

The public is growing distrustful of bonds. As millions cash in their savings bonds and get back dollars that buy only 55 to 70 percent as much as those that they invested in 1941, 1942, 1943, and 1944, that distrust mounts. Congressional and Treasury permission to keep their funds invested in savings bonds at 2.9 percent is not likely for long to allay that fear.

If people are to continue to buy bonds, something better than that must be offered. Something must be done to rehabilitate the government's credit so that taxes will not have to be raised to levels that will unquestionably discourage productivity, and so that further creation of money and bank credit can be avoided, or at least limited.

### Suggested Solutions

Last year Professor Sumner Slichter of Harvard University suggested that the Treasury issue a bond bearing a Treasury guarantee to return to the holder the same purchasing power in dollars that the original investor put up. The great flaw in this outwardly attractive proposition is that such bonds, if issued in any great quantity, would force down the value of other unprivileged bonds. That would speed up monetization of the debt or cause heavy losses to financial institutions holding the unprivileged bonds. So also would a resurrection of the Civil War plan of making government bonds payable, interest and principal, in gold dollars of the present weight and fineness. Likewise blanket increases in interest rates on all government securities would cause sizable readjustments

in the markets for all other securities.

What then can be done to rehabilitate the bond market? The nation has had considerable experience with war bonds since the Civil War. Why not draw on that experience? Why not learn something from the advantages of the methods used in three great wars, and yet avoid the disadvantages of those same methods as much as possible?

The chief advantage of the Civil War system was that the bonds were redeemable, interest and principal, in gold and hence the purchaser believed that his purchasing power was protected. The chief disadvantage, of course, was permitting such bonds to be purchased with depreciated greenbacks.

The chief advantage of World War I bonds was that the government did not worry much about their market price. The major disadvantages were two: namely, that too many were sold to banks, and that the market for their resale was temporarily very poor in the depression of 1920-1922.

The chief advantage of World War II bonds was that the government made an apparent, if somewhat unsuccessful, effort not to sell them to banks. Their chief disadvantage was the guaranteed market price.

For the present situation a bond is needed that will avoid most of the disadvantages just cited and will combine most of the advantages. Such a bond would be purchasable with currency that is not depreciating and would be payable in gold. It should not be sold to banks, and its value should be established through sales in markets in which the Federal Reserve would par-

ticipate as little as possible. Is it possible to have such a paragon of a bond? We can come close to having such a one although, like World War I bonds, it would not be immune from market declines.

### Return to a Gold Coin Standard

As was said before, if we are to avoid more and more monetization of the national debt we must find a substitute for bond supports. We need something to supplement higher interest rates, something that will make bond supports seem less necessary, and something that will reduce the chances that the Treasury will insist on them again. What can we put in place of these bond supports that will give the public more confidence in the bonds? The best feature of the Civil War bond, gold payments, should be adopted. We may do this simply by making money and demand deposits again redeemable in gold. Passage of the Reed bill now before Congress would put us back on a gold coin standard. Making all moneys redeemable in gold coin would not guarantee the dollar's purchasing power completely, but it would help considerably. It would reassure both those who are selling their bonds because they fear more serious inflation and those who are hesitating to buy bonds for the same reason. It would put all securities on the same basis and remove the problem of market readjustments. Admittedly, there might be some interest rate increases but, with gold to share the burden of reassuring the public against inflation, interest rates would probably not rise as much.

The question arises as to whether



**Table 4. Ratio of Gold to Currency Outside Banks and  
Demand Deposits Adjusted, 1914-1951**  
(Dollar amounts in billions)

Year	(1) Gold holdings	(2) Currency outside banks and demand deposits adjusted	Ratio of (1) to (2)
1914.....	\$1.5	\$11.6	12.9%
1915.....	2.0	11.4	17.0
1916.....	2.6	13.8	18.9
(1917-19, gold standard suspended)			
1920.....	2.6	23.7	11.0 (low)
1921.....	3.4	20.8	16.3
1922.....	3.6	21.4	16.8
1923.....	4.0	22.9	17.5
1924.....	4.2	24.6	17.1
1925.....	4.1	26.1	15.7
1926.....	4.2	25.5	16.5
1927.....	4.1	26.4	15.5
1928.....	3.9	26.7	14.6
1929.....	4.0	26.4	15.1
1930.....	4.3	24.6	17.5
1931.....	4.3	21.9	19.6
1932.....	4.2	20.4	20.6 (high)
1933-34, gold standard suspended. Resumed in 1934 following 41% devaluation.			
1935.....	10.1	27.0	37.4
1940.....	22.0	42.3	52.0
1945.....	20.1	106.0	19.0
1948.....	24.2	111.6	21.6
1950.....	22.7	117.7	19.4
1951 (June).....	21.8	114.5	19.0
Average ratio for gold coin standard years 1914-32.....			16.35

Source: Board of Governors. *Banking and Monetary Statistics*, pp. 34, 536; *Federal Reserve Bulletin*.

Gold figures are for December unless otherwise indicated; currency and deposit figures are for June, 1914-22, thereafter for December. Devaluation in 1933-34 increased our dollar holdings of gold by 69 percent and tremendously stimulated gold mining; for it assured gold producers \$35 an ounce instead of \$20.67.

there is enough gold to do this. There is. In the period of the gold coin standard, 1914-32, we had less gold back of our currency and demand deposits than we have today. The average then was \$16.35 per \$100 as compared with \$19.00 today. (See Table 4.) Our

present gold reserve is one of our greatest and one of our least used assets. We should use it. Gold convertibility would stem the tide of inflation and it would rehabilitate the bond market. Both results would necessarily lighten the tax burden.

If there was any justification in 1933-34 for abandoning the gold coin standard because of the depression and unemployment (I doubt that there was), certainly such justification no longer applies in today's era of prosperity and full employment. A condition now exists which not only favors a return to the gold coin standard but cries out the need for it.

### Conclusion

The original title for this article was "This is where great-grandfather came in." Continuous shows repeat themselves and so does history. By the time a show repeats itself most of the audience is new and that is true of history, too. So the cynic says, "The chief thing that we learn from history is that we do not learn from history." That is too often true, but it is not always true and does not have to be this time.

In the matter of war bonds, we have completed a cycle and are back to a situation closely resembling that of the Civil War. Let us learn from the experiences our country has had since then. We must not expect the results to be perfect, of course, but they should be better than if we take the chance of reverting to the World War II method. The conditions justifying bond supports have passed, if indeed they ever existed. We should not even think of reviving this method. The bond-support system has too many serious faults. It inflates the currency, discourages bond buyers, and dilutes the tax dollars. We need instead a system that will reduce currency inflation, encourage bond buyers, and stretch tax dollars. Return to a gold coin standard to supplement our freer bond market system seems most likely to accomplish this.

# An Analysis of Federal Budgets

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WITH THE FEDERAL BUDGET currently running at about one fifth of the national income, it is important that there be a clear understanding of what the budget is, how it is constructed, and for what purposes it can be used. This article will examine various types of budgets which have been used or have been proposed, in order to see how they can affect the operation of the economy.

In the United States, the use of a Federal budget is a comparatively recent development. Despite several attempts to install a budgetary system, the Federal government did not adopt such a procedure for control of its expenditures until 1921.

The establishment of the Bureau of the Budget and its issuance of a budget were hailed as a great step forward, which was to insure the achieving of dual goals—efficiency and economy in government. The budget then presented was the executive or administrative budget as we know it today.

Since its inception, the budget has been an object of both veneration and criticism. The cry for a balanced budget has helped to elect presidents, and many of them have been haunted by the specter of a deficit. The mere use of the terms “budget” and “balanced” brings up an entire complex of problems. What is a budget? What does it include? What are its primary functions? So far as balancing is concerned, any budget balances; but the balancing of a governmental budget

means an equality of receipts and expenditures, excluding from receipts any funds raised by loans or other borrowing. Repayment of any debt is not considered as part of expenditures. This definition of budget balancing will be used throughout the article.

The budget of any governmental body is a complex and intricate document. It is, however, more than a document. In reality, it is a symbol of the success with which governmental functions are carried on, and should serve as a tool for making possible the attainment of certain goals. Principles have been advanced that should underlie all budgets. One of these is unity, or the treatment of all expenditures and receipts in one coherent document. Violation of this principle is thought to result in shady and questionable practices, whereas its observance is a mark of healthy and orderly finances. Second, a budget should be specific; that is, it should point to a specific pattern of activity, and to no other. Third, a budget should be so clearly worded that it leaves no doubt or opportunity for choice of those who read it or are to be guided by it. Fourth, a budget should be set up for a year, or for some other definite period.

A “budgetary symbolism” has grown up about the words used in describing a budget—balanced, sound, healthy, annual, and so on—so that the real meaning of these words has become lost in some strange normative connotation. Thus it is clearly necessary to define

exactly what is meant by a budget in any discussion of the subject. Moreover, the principles which have been set forth to guide budgetary policy must be applied in accordance with their applicability to the particular type of budget under consideration.

Budgets are like roads, in that the particular value of each is to be found in its usefulness in getting to a desired objective. All types of budgets serve to allocate funds among the competing groups within a government. Certain functions, however, are performed to varying degrees by various types. For instance, the administrative budget is best adapted to control expenses, in order to achieve efficiency and eliminate waste. The effect of the budget on the rest of the economy is best shown by the cash-consolidated budget. This is especially true when the cash-consolidated type is used in connection with the national economic budget, which measures the total output, income, and expenditures of all segments of the economy. In this way the success of the government in achieving some particular goal, whether it be growth, stability, or full employment, can best be shown.

Thus, in setting up any budgetary system three considerations which should guide the selection are allocation of funds, control of expenditures, and impact on the economy.

### **Administrative or Executive Budget**

Since fiscal 1923, the budget which has been presented by the President each year has been the administrative or executive budget. This is the budget concerning which much debate has

occurred. The question at issue has been: Does the budget balance?

When the financial operations of the Federal government were a relatively unimportant factor in the total economy, the exclusive use of this type of budget was not too serious a matter. Such a budget has certain advantages. In concept, it is a simple document listing all the expenditures that each branch of the Federal government will make. The offsetting revenue side shows the sources and amounts of the funds available for government use.

In this budget, each department lists the expenditures that it made in the past year, its expenditures for the current year, and the expenditures which it expects to make in the next fiscal year. The total expenditures include both those made currently on a cash basis and those on an accrual (payment-deferred) basis. The accrued portion does not appear in the budget for the year in which payment is actually made. The budget for each department, therefore, shows the actual cost of operating the department for that accounting period, whether payment was made in that period or not.

By following this method, Congress can ascertain the costs incurred by each department or subdivision of the government and can allocate the available funds on the basis of its evaluation of each department's contribution toward the fulfillment of the general over-all policies and goals. Thus, the cost of its service is set in bold relief, and the public, as well as Congress, can determine whether the services rendered seem to be worth their cost. This, of course, is an idealized version of the



role of the budget. In actual practice, power politics and intra-departmental diversions of funds from one purpose to another interfere with the allocation of funds desired by the public.

Despite this shortcoming, the administrative budget does serve to allocate the available funds among alternative uses. Through its use Congress and the President can formulate priorities for expenditures.

A second important value of the administrative budget is to be found in its control of expenses. In the budget each department has a limit imposed upon its operations. If these limitations are judiciously determined and carefully observed, they will result in a certain degree of economy.<sup>1</sup> They mean that a check has been placed on the expenditures of each governmental unit, and that it can spend only to the extent previously determined by Congress. This control is an important consideration in any budgetary system, and the retention of the administrative budget can be justified on this basis.

Exclusive use of the administrative budget, however, has certain weaknesses. Its most serious defect is that it does not adequately measure the impact of the budget on the economy. Other shortcomings have become apparent. For one thing, the operations of the trust funds have practically no net effect on this type of budget. Again, the greater use of the governmental corporation device presents another problem. Under present pro-

cedures, if the services of such a corporation are similar in nature to those of private corporations only the net surplus or deficit is included in the budget. This treatment clearly leaves much to be desired, especially when considering the impact of the budget, for its effect upon the economy is more than merely the amount of the net surplus or deficit. In other cases, the total receipts and expenditures of government corporations are included in the budget totals.

As the scope of government activity grew and its expenditures came to be larger and more complex, the weaknesses mentioned became both more apparent and more serious. No budgetary system can be perfect for all purposes and at all times. Our Federal budget has necessarily been revised and adapted to new conditions.

### Cash-Consolidated Budget

A new division, called "Receipts from and Payments to the Public," was carried for the first time in the budget for the fiscal year ending June 30, 1944. As has just been explained, the administrative budget, which is usually regarded as "the budget," includes and excludes many items with varying degrees of impact on the functioning of the economy. The new division introduced in 1944 was a significant step in revealing the impact of the Federal budget on the total economy.

The purpose of the new classification is to present a picture of the flow of money between the Federal government as a whole and the public. It is not intended to replace the other budgets but merely to supplement them. None of the other budgets purports to show

<sup>1</sup> It must be realized that simply limiting the budget itself will not bring efficiency, for waste should not be thought of in relation to the total expenditures, but only in relation to the services provided by a certain amount of funds.

<i>Item</i>	<i>Administrative Budget</i>	<i>Cash-Consolidated Budget</i>
<b>Interest</b>	Lists accruals of interest due on bonds as expenditures. The largest item is for interest due on Series E bonds accrued but not paid. In 1948 this budget listed \$804 million as accrued interest on the savings bonds.	Interest is included as an expenditure only when it is actually paid. Only \$268 million was listed as expenditures for Series E bond interest in 1948. This was the interest paid on the bonds actually redeemed.
	Interest paid on securities held in trust funds is listed as an expenditure. In 1948 this item amounted to \$746 million.	No intragovernmental transfers are listed in the budget.
	Interest is paid to various government agencies on their holdings of government securities, and interest is paid by them to the Treasury for advances and loans. These items are listed as expenditures and receipts.	No intragovernmental transfers are listed in the budget.
<b>Trust Funds</b>	Payments from the Treasury to the trust funds are listed as expenditures. Certain payments from the trust funds to budget accounts are listed as budget receipts.	No intragovernmental transfers are listed in the budget.
	Payments to the public from trust funds are not listed as budget expenditures.	Listed as payments to the public.
	Federal old age tax is listed as a receipt and as a deduction from receipts; therefore no net figure is shown.	Listed as a receipt from the public. This item amounted to \$1,616 million in 1948.
	Veterans' insurance premiums and unemployment tax are received directly into the funds, and are not listed as budgetary receipts.	For 1948, insurance premiums of \$424 million and unemployment tax of \$1,007 million were listed as receipts from the public.
	Dividends on National Service Life Insurance are not listed as expenditures.	Dividends on National Service Life Insurance amounting to \$2.2 billion were listed as payments to the public for 1950.

the exact amount of cash received from the public (individual consumers, business firms, and state and local governments, both here and abroad), and paid to the public, by the Federal government. Each of the others serves its individual function and gives certain

information, yet none of them can be considered as "the budget."

In the maze of Federal accounting, the administrative budget shows some glaring defects. Some flows of funds between government agencies are included as receipts and expenditures.

Item	Administrative Budget	Cash-Consolidated Budget
<b>Terminal Leave Bonds</b>	Terminal leave pay bonds were entered as an expenditure in the year in which they were issued. In 1947 they amounted to \$1,998 million and in 1948 to \$269 million.	Terminal leave pay bonds are shown as a payment to the public only when redeemed. Thus, for 1948 a total of \$1,455 was shown, whereas the 1947 budget contained no figure for this item.
<b>International Fund and Bank</b>	The United States subscription to the International Monetary Fund and the International Bank for Reconstruction and Development, in the form of non-interest-bearing notes, was entered as an expenditure of \$1,426 million for the year 1947. No notes have been issued since that time.	No entry is made until the notes are redeemed. In 1948 payments to the public included a total of \$913 million for these redeemed notes.
<b>Government Corporations</b>	The amount expended for setting up a government corporation is listed as an expenditure.	No payment to the public is shown until the funds leave the corporation.

Note: The comparisons shown in this listing were compiled from *Special Study No. 1, Receipts from and Payments to the Public*, Bureau of the Budget, January, 1949; *Receipts from and Payments to the Public*, Bureau of the Budget, January, 1950; and *The Budget of the United States Government*, fiscal years 1949, 1950, and 1951.

Other funds go from the government agencies to the public or from the public to the government but are not included in the budget. Although for certain operational purposes these differences in procedure might be justified, they hamper any attempts to evaluate the impact of the Federal government on the rest of the economy. For this purpose the "Cash-Consolidated Budget,"<sup>2</sup> or the "Receipts from and Payments to the Public" budget, is more useful. So far as accounting for governmental corporations is concerned, however, it does not measure their full impact on the economy.

The major differences between the two budgets are shown in the accom-

panying tabular form, as they affect various types of transactions.

The cash-consolidated budget is constructed by making adjustments in the conventional budget, but the comparisons in the treatment of various items clearly show that such adjustments may be substantial in character. Consequently, it is meaningless to make the statement "The budget is in balance," unless one specifies which budget is meant. There may be a deficit in one budget at the same time that the other shows a surplus. It is impossible to show that in the long run the two budgets will disclose the same aggregate figures. That fact, however, is of no value in analyzing current fiscal operations to measure their impact on the rest of the economy.

<sup>2</sup> This is the name given it by the Committee for Economic Development.

The use of the two budgets presents certain additional problems. Although the writer does not feel that the mere act of balancing the budget has any value unless several other factors are taken into consideration, there are many people—including some Congressmen—who do regard a balanced budget as of prime importance. The question then arises: "Which budget is to be balanced?" An examination of the surpluses and deficits in the two budgets, as shown in the accompanying table, will reveal significant differences in the handling of certain items.

**Government Surplus or Deficit, as Shown  
by the Administrative Budget and the  
Cash-Consolidated Budget, 1932-1951**  
(Billions of dollars)

Fiscal year	Adminis- trative	Cash- Consolidated
1932 . . . . .	-2.7 <sup>a</sup>	-2.7 <sup>b</sup>
1933 . . . . .	-2.6	-2.6
1934 . . . . .	-3.6	-3.3
1935 . . . . .	-2.8	-2.4
1936 . . . . .	-4.4	-3.5
1937 . . . . .	-2.8	-2.8
1938 . . . . .	-1.2	-0.1
1939 . . . . .	-3.9	-2.9
1940 . . . . .	-3.9	-2.7
1941 . . . . .	-6.2	-4.8
1942 . . . . .	-21.5	-19.4
1943 . . . . .	-57.4	-53.8
1944 . . . . .	-51.4	-46.1
1945 . . . . .	-53.9	-45.0
1946 . . . . .	-20.7	-18.2
1947 . . . . .	+0.8	+6.6
1948 . . . . .	+5.4	+8.9
1949 . . . . .	-1.8 <sup>c</sup>	+1.0 <sup>d</sup>
1950 . . . . .	-5.5 <sup>c</sup>	-4.9 <sup>d</sup>
1951 . . . . .	-5.1 <sup>c</sup>	-2.7 <sup>d</sup>

Sources: <sup>a</sup> *Statistical Abstract of the United States*, 1949 (Washington: GPO, 1950), Table No. 359, p. 327. <sup>b</sup> *Ibid.*, Table No. 361, p. 330. <sup>c</sup> *Budget of the United States Government for the Fiscal Year Ending June 30, 1951* (Washington: GPO, 1950), p. A 117. <sup>d</sup> *Ibid.*, p. M 5.

In fiscal 1947, for example, the administrative budget showed a surplus of \$0.8 billion, whereas for the cash-consolidated budget the surplus figure was \$6.6 billion. This difference can be partly accounted for by almost \$2 billion in terminal leave pay bonds which were included as an expenditure in the administrative budget for 1947 but were not actually paid until 1948. Also included in this category was \$1.5 billion representing the subscription of the United States to the International Monetary Fund and the World Bank. The remainder of the discrepancy was largely the result of trust funds receipts and payments. In 1949, for instance, trust fund transactions were mainly responsible for the fact that one budget showed a small surplus and the other a slightly larger deficit.

From these illustrations and further examination of the table, it seems clear that the phrase "balancing the budget" has meaning only when there is a definite indication of what budget is being considered.

The President's Council of Economic Advisers has used the cash budget exclusively in investigating the effects of governmental operations on the rest of the economy. The Council made the following statement in regard to the use of the cash budget:

The best available general measure of these economic impacts is the volume of current cash transactions, other than borrowing, between government and public without regard to whether these transactions arise in connection with the receipts and expenditure accounts of the regular budget or in connection with social security or other trust accounts or whether they represent cash payments of some liability which accrued and was recorded



as a budget expenditure at some previous date.<sup>3</sup>

This cash budget, however, does not serve nearly so well as a control mechanism, or as a method of allocating funds among the governmental agencies, as does the administrative budget. Thus any ideal budgetary document should contain at least these two types of budgets.

### Trust Funds

The major differences between the administrative budget and the cash-consolidated budget arise from the activities of the various government trust funds. A brief examination of the nature and purposes of these funds may be advantageous at this point.

The trust funds (or accounts) are amounts of money which have been set aside for special purposes. The more than 150 accounts can be grouped into three general classifications. First, but least important, are those composed of money and property received directly from individuals or private organizations to be used for specific purposes. In this group are included such accounts as the Ainsworth Library fund, the Library of Congress trust fund, and similar funds. The second group has at times been more important, but its importance is not of a continuing nature. It includes funds created out of money appropriated by Congressional action from general revenues and to be used for specific purposes. Examples are the adjusted service certificate fund, the District of Columbia

water fund, and the Pershing Hall Memorial fund. The third group is the really important one. The funds it includes are composed of money collected as regular contributions under specific programs. The largest of these are the unemployment trust fund, the Federal old age and survivors' insurance trust fund, the veterans' life insurance funds, the railroad retirement fund, and the Federal employees' retirement funds. At present the assets of these five largest trust funds total more than \$34 billion.

Each trust fund has been authorized by a special act of Congress which stipulates the source of money, the administrator of the fund, the investment official for the fund, and the types of securities that are eligible for investment of surplus moneys. In addition, administrative procedure has implemented the statutory provisions to designate certain specially issued securities as the investment media for certain funds. Thus, the law states that the Federal employees' retirement funds will be invested in interest-bearing securities of the United States or Federal land banks. Administrative procedure, however, has designated a 4 percent special Treasury issue for the use of these funds. Similarly, a 3 percent rate has been designated for the National Service Life Insurance fund (World War II veterans) and a 3.5 percent rate on the U. S. Government Life Insurance fund (World War I veterans). Originally the investment of the old age funds was limited to a special 3 percent Treasury issue. This was changed by legislation in 1939 to conform to the rate set for the unem-

<sup>3</sup> *Economic Reports of the President* (New York: Harcourt, Brace & Co., Inc., 1949). Reprinted from the *Annual Economic Review: January, 1949* of the Council of Economic Advisers, p. 26.

ployment funds. Surplus money in these two funds can now be invested in regular marketable issues of the government or in special issues which bear a rate equal to the average rate of interest on the public debt as of the calendar month next preceding the date of issue. The former provision has enabled the Treasury to participate in the open market with the resources of the trust funds to stabilize bond prices when it felt that the market should be supported.

The trust funds have continually been growing in volume. From receipts of less than \$1 billion in fiscal 1937, they have expanded until in 1948 the peak was reached, with total receipts of \$6.8 billion. Even under existing legislation it has been estimated that receipts will climb to \$7.2 billion in 1955. Expenditures were only \$0.1 billion in 1937 but had risen to almost \$3 billion by 1949. Dividend payments to veterans on their National Service Life Insurance swelled total expenditures for 1950 to \$6.1 billion and to an estimated amount of \$4.2 billion for 1951. Surpluses began with \$0.6 billion in 1937 and rose to more than \$5 billion in 1945. They have since declined, and projections for 1952-55 indicate a leveling off at less than \$3 billion. Surpluses have been shown and are projected for every year except 1950, when the deficit of \$1.2 billion was mainly caused by the veterans' insurance dividend payments.

As the size of receipts by and expenditures from the trust funds has increased, the differences between the administrative and the cash-consolidated budgets have widened. For example, in 1949 and 1950 expenditures

of \$3 billion and \$6 billion, respectively, were not part of the administrative budget. If expenditure totals shown by the administrative budget were being used to measure the amount of purchasing power initiated by the government, the total would be understated by the amount of the trust fund expenditures. On the other hand, receipts by the trust funds are not shown as administrative budgetary receipts. (The receipts of certain trust funds are shown both as a receipt and as an expenditure, or a deduction from budgetary receipts, the net result being that they do not affect total receipts in any way.)

Any surplus in current trust fund operations means that receipts from the public are larger by that amount. Since these operations have resulted in a surplus for every year except fiscal 1950, their net effect has been to decrease the purchasing power remaining in the hands of the public. This fact is not revealed by the administrative budget; only when the cash-consolidated budget is used can it be seen.

### Impact Budget

Thus far, this article has considered only the budget totals as a measure of the governmental impact on the rest of the economy. Such use of budget totals alone, however, oversimplifies the case, for various components of both the receipts and the payments sides differ in their effects on the economy. No attempt will be made here to qualify this concept. The problem will merely be presented.

Economic literature is filled with discussions of the incidences of taxation, and of the effects of various kinds of

taxation on incentives, output, and employment. At this stage of economic knowledge the effects of the various types of taxes cannot be stated definitely and with precision. It is believed that consumption expenditures are affected more by payroll taxes, personal income taxes at the lower levels, and excise taxes than by corporation income taxes and high progressive income taxes. Thus, within certain given assumptions, the former group is considered to be more deflationary in effect than the latter. In an examination of any budget, therefore, the components of the receipts, or the tax structure, should be analyzed.

Although two budgets may show the same totals they may have vastly different effects on the total economy. The effect of inheritance taxes as against that of payroll taxes, for example, will change incentives. A highly progressive income tax will have effects on the economy different from those of a sales tax, even if the total revenues raised are the same. Thus, a source of revenue must be considered not only in the light of raising a certain total amount of revenue, but also as to its effects on the entire economy or its capacity to achieve some social goal. If the desired goal were a redistribution of wealth, for example, the raising of a given total revenue would require a tax program heavily weighted with inheritance taxes and highly progressive income taxes. If the policy were aimed at decreasing disposable consumer income, or on the contrary at increasing it, different types of tax programs would be needed.

The expenditures side of the budget — that is, the payments to the public

— can be considered in the same way by taking into account the components which make up the total. Thus, if the aim of the government is to generate more income and thereby to increase output and employment, the choice of an expenditures pattern, as well as the total amount of the expenditures, is highly important. If the purpose of governmental policy is to stifle an inflation (a deflationary policy), the choice of the pattern or types of expenditure is likewise very important. Similarly, governmental expenditures might be used as a tool for the redistribution of income, for encouraging investment, or for other social and economic goals.

The budget may therefore be thought of not simply as a total, but as a collection of items each of which has its own effect on the operation of the economy toward the fulfillment of some over-all plan or purpose. A budget might conceivably be devised which would show the various receipts and expenditures according to their impact upon the national economy.

A beginning toward such an "impact budget" has been made by the use of the functional type of budget. As a means of supplementing the other budgets, the expenditures have been grouped according to their functions. Thus, the total of expenditures for national defense, housing, and education, for example, is shown as a single amount, instead of being reported as a part of some agency's expenditures. Not enough is known at present about the impact of the various components of the budget to permit the presentation of an impact budget which could be used with a great deal of precision.

However, as knowledge of this field grows, it will become possible to present an impact budget which may prove to be a useful tool of governmental policy.

### Emergency Budget

On several occasions in the past total expenditures of the government have been divided into two separate categories, or budgets. The first case of this was in the *Budget for the Fiscal Year ending June 30, 1935*. Here the expenditures for fiscal 1934 were divided into "general" or "ordinary," and "emergency" or "extraordinary." The intention was to finance the general expenditures from current revenues, whereas the emergency expenditures were to be financed by borrowing.

The next year, in his Budget message to Congress on January 3, 1935, President Roosevelt stressed the use of the Emergency Budget by saying:

... it is evident that we have not reached a point at which a complete balance of the Budget can be obtained. I am, however, submitting to the Congress a Budget for the fiscal year 1936 which balances except for expenditures to give work to the unemployed. If this Budget receives the approval of the Congress, the country will henceforth have the assurance that, with the single exception of this item, every current expenditure of whatever nature will be fully covered by our estimates of current receipts. Such deficit as occurs will be due solely to this cause, and it may be expected to decline as rapidly as private industry is able to reemploy those who are without work.<sup>4</sup>

Ordinary expenditures for fiscal 1936 were budgeted at \$3,302 million and receipts were to be \$3,422 million. The

emergency budget amounted to \$4,012, all of which was to be financed by borrowing.<sup>5</sup>

This budgetary procedure has been defended on the ground that it emphasizes the emergency character of certain expenditures. The attention of the country would therefore be drawn to the actual cause of the deficit and the purposes of the expenditures. The amount of the emergency deficit would be carried over and would be paid off within a certain specified period. Thus taxes would be raised and the debt reduced. This could be done either over a certain number of years, over a business-cycle period, or when certain indicators (price index, production index, or employment) showed that these deflationary factors, i.e., increased taxes and debt reduction, should be put into force. At all times the debt thus created would have a high priority of repayment. This procedure is assumed to induce adherence to governmental economy in periods of high production and income.

The use of this budgetary device has been criticized as an attempt to rationalize deficits by being able to show both balanced and unbalanced budgets at the same time. There is some question of just what items are classed as emergency and whether they can be separated from the others. Even if such a separation can be made, of what real value is the division? The purpose may be merely to fulfill a campaign promise of a balanced budget by showing that the general budget is in balance and that the deficit has been caused by the special nature of some emergency. On the other hand, it does throw into

<sup>4</sup> *Budget of the United States Government for the Fiscal Year ending June 30, 1936* (Washington: GPO, 1935) p. x.

<sup>5</sup> *Loc. cit.*



sharp relief the therapeutic expenditures of the government in bringing recovery to an ailing economic system. It may also be argued that necessary emergency deficits are more acceptable politically if they are presented in the setting of the emergency budget. To the extent that this opinion is valid, the argument has some merit.

Use of the emergency budget does not present a very important problem. However, it may disclose certain facts more vividly, as well as make the cure of economic maladies more palatable politically.

### Asset Budgets

The budgets which have been discussed up to this point have not been concerned with the increases in physical assets which result from governmental spending. Since at present no national balance sheet exists that shows the total net worth of the Federal government, no budget can reflect asset changes. Part of this lack can be traced to the difficulty of establishing values for the assets owned by the government. For example, what value should be placed on the atomic plants? Should defense expenditures be considered as part of the creation of physical assets? Furthermore, since the government does not operate in order to make a profit, subjects such as depreciation, depletion, and obsolescence — which would have to be considered — are relatively unimportant from a budgetary point of view.

Another major problem is whether to classify an expenditure as capital or as current. In Denmark the criterion of durability determines inclusion in the capital budget. Brinley Thomas would include in a capital budget any outlay

which creates a material asset of a durability greater than one year.<sup>6</sup> Sweden includes only self-liquidating investments in the investment budget. The latest classifications of the United States Bureau of the Budget list loans and acquisitions, as well as construction or improvement of physical assets, as composing the investment budget.<sup>7</sup>

The administrative budget measures the receipts and expenditures within certain definitions, and the cash budget measures the flows of cash in both directions. Neither of them is concerned with accounting for assets accumulated or consumed.

In some ways this is a serious problem. From the viewpoint of private accounting, no consideration of receipts and expenditures is complete unless it takes into account those assets which have been used up during the year. Alvin Hansen says that "only by differentiating the capital expenditures from the current capital charges can we get a clear notion of whether or not the budget is balanced."<sup>8</sup> Appropriate policy as to public expenditures can be adopted only after a consideration of capital assets accumulated or used up. For, as Hansen continues:

The capital project is worth what it costs if the annual benefits derived are at least equal to the depreciation and interest charges in addition to expenses of operation. The double budget executive and capital procedure stresses the fact that a capital project is not consumed in the year in which it is constructed.<sup>9</sup>

<sup>6</sup> *Monetary Policy and Crises* (London: Routledge, 1936), p. 126.

<sup>7</sup> Budget for Fiscal Year 1951, p. 1114.

<sup>8</sup> *Fiscal Policy and Business Cycles* (New York: W. W. Norton & Company, Inc., 1941), p. 187.

<sup>9</sup> *Ibid.*, p. 202.

The budget document should also record that portion of the expenditures which increases the productive capacity of the country. In most cases, these will be the expenditures for capital assets. The expense of building dams, roads, canals, and other projects could be recovered either by direct revenue or by the larger tax revenues which would result from the increased prosperity of the area. Many economists point to the tax revenues of the Tennessee Valley as an example of this latter effect. Expenditures for loan programs of all kinds, such as the Reconstruction Finance Corporation, the Federal National Mortgage Association, the Home Owners Loan Corporation, and the Commodity Credit Corporation, are examples of expenditures which will be recovered; they should therefore carry a different designation in the budget. Capital expenditures that do not provide such a return would be considered direct subsidies.

The terms used for budgets which take assets into account are "investment budget" and "capital budget." These terms are used interchangeably. However, in concept the former merely considers increases in assets, whereas the latter also considers depreciation, depletion, and obsolescence of existing physical assets, and anticipated losses on loan programs.

### Investment Budget

Using Bureau of the Budget terminology, the investment budget will be considered as a supplementary budget document which differs from the conventional budget only in that the budget items are broken down according to asset formation. The tabulation

below shows the conventional budget for fiscal 1949 broken down into current and investment expenditures, according to major functions:

<i>Classification</i>	<i>Millions of dollars</i>
Additions to Federal assets	
Loans.....	1,392
Physical assets.....	5,174
Expenditures for other developmental purposes	
Physical assets (non-Federal)...	721
Research, development, and surveys.....	998
Education, training, and health..	1,186
Current expenses for aids and special services.....	13,472
Other current operating expenses	
Interest.....	5,444
Other.....	10,821
Noncost payments.....	578
Adjustment to daily Treasury statement basis.....	+272
Total budget expenditures....	40,056

Source: *Budget of the United States Government*, Fiscal 1951, p. 1113.

This classification shows that more than \$6 billion of the 1949 expenditures actually went to create physical assets. Almost \$3 billion more went to create non-Federal assets and intangible assets which should increase the productive capacity of the country. Thus, almost a fourth of the budget was spent to acquire assets which would either be repaid or would increase the national income.

When this method of presentation is used, the deficit of \$1.8 billion for fiscal 1949 (administrative budget) does not seem so large or so important. This type of statement is not new to our budget documents. The Budget Message for 1940 recommended that the budget be presented with the two categories of current and of capital

expenditures. President Roosevelt used the expenditures for the years 1931 through 1940 to show that the total deficit for this ten-year period amounted to \$27,279 million, whereas Federal outlays in the same period for durable improvements, recoverable loans, investments, and a \$2 billion stabilization fund totaled \$18,431 million.<sup>10</sup> A budget prepared in such a manner, he believed, would "permit the presentation to the Congress and to the public of more accurate and intelligible statements of the financial operations of the Government."<sup>11</sup>

Not until the Budget Message of 1951 was this classification again presented, although at the request of Senator Wayne Morse the Bureau of the Budget had prepared a similar budget for fiscal 1948. In that report the Bureau showed that in the 1948 budget more than \$7 billion represented expenditures which either created wealth or would be returned in future years.<sup>12</sup>

The classifications in the 1951 investment budget document are necessarily experimental in character. There is no complete agreement on the categories in which expenditures can be placed. However, this supplementary budget should prove to be a great aid in determining economic policies for the nation. By its use, we should be able to measure the contributions which the Federal government is mak-

ing to the productive capacity of the nation and learn what tangible assets have been placed under governmental control. Here again, as with the emergency budget, there is the danger that this budget might be used simply as a means of explaining away deficits—in this case, by pointing to increased assets. It must be remembered that mere creation of assets is not a justification for spending. Other considerations, such as need and impact of the expenditures on the economy, are far more important.

### Capital Budget

The use of a capital budget means the adoption by the government of private accounting concepts. In the capital budget, as in the investment budget, expenditures are classified as to whether they are current or capital. The difference in the two budgets, however, is that the capital budget would show an imputed charge for that portion of the capital which has been used up during the accounting period. Thus, on the expenditure side of the budget there would be an amount representing depreciation, depletion, and obsolescence of assets. The budget would then be considered in balance only if the current receipts balanced the current expenditures plus these capital allowances. A national balance sheet would have to be drawn up to show the total assets and the total liabilities at some certain date.

The investment budget described in the previous section would have to show a net figure after consideration of depreciation, depletion, and obsolescence. The operations of one year would be weighed in terms of whether

<sup>10</sup> *Budget of the United States Government for the Fiscal Year ending June 30, 1940* (Washington: GPO, 1938), p. x.

<sup>11</sup> *Loc. cit.*

<sup>12</sup> "Capital Expenditures in the 1948 Budget," *Congressional Record*, July 10, 1947 (Vol. 93, Part 7, 80th Congress), pp. 8596-8602.

the value of assets accumulated was greater than that of those used up, thus supplementing the current receipts and expenditures. The budget would then be similar to a "profit and loss" statement of a corporation, with a supplementary national balance sheet showing the net worth of the government.

But what would be gained by this procedure? If the entire budget were to be included, there would be little gain. Almost of necessity, arbitrary and unsatisfactory classifications would have to be made. For many operations of the government this would be virtually impossible. The use of these concepts in Federal accounting would, however, possess certain merits. In government corporations, or in other businesslike activities of the government, charges for depreciation and the like are valid and necessary to appraise properly the efficiency of their operation. Supplementary budgets for these various activities of the government, which are of a quasi-business nature, should adhere closely to private accounting concepts. The governmental operation of any segment of industry (power plants, synthetic rubber, barge lines) should take into account the profit or loss of such operations, including charges for depreciation. Any net loss which would then be chargeable to general revenues should be weighed against the benefits of governmental operation of these facilities, e.g., conservation, defense, flood control, or education. As the government extends its activities into the business field, it should adopt this type of budget to a greater extent for these quasi-business operations. Such budgets, however, will always be merely sup-

plemental to the administrative and the cash budgets.

### Social Budget

All the budgets, with the exception of the impact budget, which have been analyzed here have adhered to normal accounting concepts. This means that a budget is considered in balance when the numerical quantities on the two sides of the balance sheet are the same. It means that a pricing mechanism concept is used, so that the satisfaction or utility that a nation receives from its expenditures may be roughly measured by the amount of the expenditures. Similarly, its receipts should serve as a rough measure of the amount of utility which the nation is transferring to the government. The importance or social value of many governmental activities cannot be measured by the amount of money spent on them. The normal type of budget may show a surplus in dollar terms but upon analysis it might reveal several social deficits in program and policy.

Some attempt can be made to construct a budget along lines of social value. Only a concept is presented, and there is no intention to give it numerical value. There is too little agreement on social goals — and even less on how to measure any success in attaining them — to make such an attempt worth while. The field of welfare economics is still not sufficiently developed for wide use to be made of its theories. The basic idea is to measure the social effect of the government. There are several ways in which this may be done.

One way is to capitalize the expenditures according to some goal that



should be maximized. Each expenditure would then be given a "weight," according to the social goal. This would be similar to A. P. Lerner's concept of Marginal Social Product. On the receipt side, the social product lost because of taxes would be measured. (Actually, a gain might result by virtue of a more equitable distribution of income.) Thus some idea of the social values added or subtracted by the government could be obtained. The aim would be at least to balance these, or preferably to gain more than is lost.

The total satisfactions which would exist in an economy in the absence of government could also be measured by any desired method. Such a measurement would disclose whether governmental action has increased or decreased total satisfactions. This could be done by means of a step-by-step process, with the effect of each action analyzed. It must be recognized, however, that a step-by-step analysis may not be feasible, for many of the benefits accrue only when the totality of action is taken into account. This situation results from the high degree of interdependence and complementarity in governmental and private activities.

A social budget might possibly be approached from the point of view of its impact on the national product. For example, an expenditure of \$3,500,000 for the antitrust division of the Department of Justice might add many times that amount to the national product. Because of secondary investment and improvements of all kinds, expenditures for large river-basin developmental projects might increase the na-

tional product. Actions, or absence of actions, which subtract from national product should also be considered. Thus, a bad farming policy, a poor conservation policy, or unchecked crime might all be considered as lowering the national product. Here also would be classified those governmental expenditures which add less to the national product than would similar projects undertaken by the private segment of the economy.

These concepts are now implicit in our budgets. Some expenditures are given priority over others by virtue of values other than those which would be attributed by a strict pricing mechanism. Any of these concepts, parts of them, or combinations of them could be used in conjunction with more formal budgets. Whereas the impact budget would more accurately reflect the impact of the national budget on the total economy, the social budget would act as a barometer of the attainment of social objectives.

### Summary

This article has attempted to present the various types of budgets which the Federal government does use or could use. The over-all conclusion reached is that each of them answers only a few of the questions that arise in the operation of the government. It is clear that an ideal budget document should contain several budgets, each presenting a specific aspect of governmental operations.

Moreover, it should be recognized that the term "balancing the budget" is meaningless unless one carefully defines the budget which is being used.

Also, the normative values are in even greater need of clear definition. For example, if balancing the budget is "good" per se and the administrative budget is used, then the cash budget might not be in balance. Any normative judgment as to balancing of the budgets should indicate how well governmental operations, as reflected in

the budget, achieve desired goals. These goals should be carefully defined. Is the desired goal economy, full employment, growth, stability, peace, or freedom? Only in the light of achieving specified goals can the operations of the government, as reflected in the various budgets, be considered successful.

## Books Reviewed

*The Corporation Income Tax.* By Richard Goode (New York: John Wiley and Sons, Inc., 1951, pp. 242. \$3.00)

In this book Professor Goode presents an interesting and stimulating economic analysis of the corporation income tax. Throughout the study it is assumed that the major ends of fiscal policy are a reasonable degree of equality of individual income and wealth, full employment, and a high level of real income. Running also throughout the book is the implicit assumption that maintenance of a level of demand sufficient to assure full employment will pose a long-run problem in the United States. The effects of the corporation income tax on national income and employment are thus given special emphasis, and the consistency of the tax with the assumed objectives of fiscal policy is tested.

Attention is focused on the Federal corporation income tax, although numerous comparisons are made between this tax and alternative means of financing. Only brief references are made to special problems of state taxation. The approach of the study is essentially that of an economic analysis, and it does not purport to present more than incidental treatment of the many technical details of accounting, law, and administration.

Early in the study the nature of the modern corporation as a legal and economic entity is examined. This is followed by consideration of the question of whether corporations as such should be taxed. The conclusion is reached that the corporation income tax merits

a place in a well-rounded revenue system. Special attention is given to the criterion of social usefulness in considering the justification for the tax.

Recognition is given to the fact that the effects of the tax upon income, investment, and employment depend to a large extent upon the extent and direction of shifting. An entire chapter is devoted to the question of incidence. The approach to the study of the general price effects of the tax is through an analysis of changes in aggregate demand or money income. The incidence of the Federal and most state taxes on corporation net income in the short run is held to be on corporations and their stockholders. The analysis does not lead to equally positive conclusions relative to long-run shifting. That the tax adversely affects groups other than stockholders and probably causes some changes in relative commodity prices in the long run is admitted. On the other hand, little foundation is observed for the belief that a large part of the tax comes out of wages or is shifted to consumers to the same extent that a selective excise tax is shifted to buyers. The importance of the conclusion, for both analytical and policy purposes, that the short-run incidence is largely on corporate profits is emphasized. This position is consistent with the author's assumption as to the basic objectives of fiscal policy.

Since the assumptions relative to incidence are crucial to the conclusions as to the economic effects of the tax, it should be pointed out here that the author is forced to rely almost entirely on deductive rather than on experi-



mental or inductive proof in his analysis of shifting. Unfortunately, empirical verification of tax incidence is difficult, if not impossible.

Data compiled from income tax returns and published annually in *Statistics of Income* are used in analyzing the effects of the corporation income tax on the distribution of income and wealth. With some qualifications, the tax is found to be a progressive element in the tax system. Because the corporate tax reduces dividends, it brings about a proportionately greater reduction in large disposable incomes than in small disposable incomes. By preventing tax-free reinvestment of profits and reducing the appreciation in value of stock, the corporate tax on undistributed profits also contributes to the progressivity of the tax system. It is conceded that the corporation income tax is a far weaker and less precise instrument of progressive taxation than the individual income tax.

Based upon the hypothesis that the major part of the present corporate tax comes from retained profits rather than current dividends, the tax is held to reduce the consumption component of total demand much less than the other principal Federal taxes. The analysis of the effect of the corporation income tax on investment leads the author to the conclusion that the tax probably restricts private investment more in proportion to its net yield than any other major Federal tax.

The effects of the tax on consumption and private investment are combined for the purpose of appraising its influence on national income and employment. This procedure is justified by the assumption that the volume of

government expenditures is independent of the amount of revenue produced by the corporate tax. The analysis supports the opinion that a fairly heavy corporation income tax is compatible with maintenance of a high level of money national income. Replacement of the corporate tax by an increase in the individual income tax, excises, or payroll taxes seems more likely to reduce money national income than to increase it.

Professor Goode concludes that the corporation income tax, from an overall standpoint, is consistent with his assumption stated above relative to the major ends of fiscal policy. Although the tax is by no means a perfect one, the author considers it to be our second-best tax—second only to the individual income tax. Its continued use as a major feature of the Federal tax system and its wider use in state tax systems are thus believed to be warranted.

Because of the lack of definitive proof as to incidence, the author's conclusions relative to the economic effects of the tax will not be universally accepted. The skillful manner in which the modern tools of economic analysis have been employed seems likely, however, to command wide respect. The book is a valuable contribution to the literature on the subject and deserves to be widely read.

H. K. ALLEN

*Trade and Agriculture.* By D. Gale Johnson (New York: John Wiley & Sons, Inc., 1950, pp. vi, 198. \$2.50).

The subtitle of this little book, "A Study of Inconsistent Policies," is somewhat more descriptive than is its title.



This is an analysis of the conflict between our farm program, which pegs domestic farm prices above world levels and hence leads to trade controls, and our foreign economic policy, which features freer trade. The first five chapters sketch the origins, nature, and ramifications of this clash; the concluding six chapters set forth and support proposals designed to reconcile the two policies.

Much of the onus for this policy impasse is placed upon a nationalistic farm program which interferes with the free market and leads to such trade-disruptive devices as export subsidies, import quotas, tariff quotas, import excise taxes, and escape clauses. When the American price of a farm product is held materially above the world price, not only are imports encouraged but export subsidies are granted in order to dump our exports at the lower prices prevailing abroad. Such dumping sometimes results in the ultimate return of the dumped commodity, in raw or processed form. In any case, quotas, tariffs, and excise taxes are likely to be applied to prevent an influx of foreign farm products. The root of the difficulty is the price-support segment of farm policy; the author acquits of blame that portion of the farm program which does not rig prices.

Our foreign economic policy, which is generally supported in this book, is nevertheless held to be partially responsible for this conflict of programs. Although a "liberal" trade policy is judged to be not inconsistent with achieving equality of income between the agricultural and nonagricultural segments of our economy, it is charged

with contributing little toward stability of farm prices and incomes. Commodity agreements, sometimes included in our trade program as a stopgap attempt to bring stability, are labeled generally ineffective. The author concludes that both sets of policies, farm and trade, must be modified. Farm policy must include less price tinkering and make less use of quotas and other restrictionist devices; trade policy must continue to press toward freer and expanded commerce, but it must make some provision for greater stability in the internationally-traded raw materials.

The second half of the book includes a valiant attempt to stipulate changes in farm and trade policies that might minimize the conflict. Prevailing farm policy is indicted as inducing an inefficient allocation of resources, a misdirection of productive effort, and a clogging of markets and trade. In place of this policy, featuring a system of price supports, the author proposes a five-point program designed to bring income equality and greater price and income stability to farmers. Much of this program is a mosaic of familiar materials, inasmuch as most of the specific measures proposed have long been tried or suggested. The combination, however, is new. This is a proposal which would minimize direct interference in farm markets.

The suggested program includes: (1) a national food and fiber program, including new market outlets, increased marketing efficiency, extension of school lunches, and an enlarged food stamp or allotment plan; (2) direct income payments during industrial depressions, on a disaster floor rather than

a permanent plateau basis; (3) a national storage program to eliminate fluctuations in supply resulting from variations in yield; (4) a "conversion" program for distressed areas, featuring development of nonfarm opportunities, vocational education and job training, aid in enlarging and adapting farms, and transitional income payments; and (5) forward prices, to transfer price uncertainty from the individual to society without undertaking a rigid long-term system of price supports. Such a program, the author argues, would help farmers attain higher and more stable incomes without necessitating the sabotage of trade policy.

In the final section of the book, an attempt is made to suggest changes in our trade policy which might aid the farmer in his search for stability. Proposed is the substitution of either a buffer stocks program or a commodity reserve plan for our haphazard, spasmodic, and sometimes abortive system of commodity agreements. In the final full-length chapter, a thoughtful if perhaps necessarily inconclusive analysis is made of the world-wide problem of agricultural poverty. The author rejects large-scale surplus disposal as a long-range solution; economic development programs are held to have much more promise but to involve a staggering variety of economic, social, and political problems.

This is a competent, pertinent, and frequently thought-provoking book. The first half of the study, dealing with the causes and scope of the problem, is adequate but occasionally perfunctory. For example, it deals at length with the restrictionist outgrowths of our price-support policy, such as im-

port quotas, but it describes only casually the way in which a divorce of domestic and world prices sets up such a chain reaction. Indeed, when farm policy is finally examined directly, the means of maintaining price support are described but the support program itself is scarcely mentioned. Such treatment may be slanted toward agricultural economists or others long familiar with farm policy; it may merely reflect the assumption of the author that everybody knows about price supports or it may mirror a feeling that the conflict has already been fully diagnosed in print. In any event, this section may take a bit too much for granted to be a wholly satisfactory guide for the general reader.

The section setting forth policy proposals is more controversial and fragmentary but it is also more venturesome. The proposed farm program would probably minimize the clash between our farm and trade policies although it appears that this outcome would be a happy by-product of a policy advanced by the author on larger grounds. The section on trade policy is much less satisfactory, but admittedly the whole commodity agreement—buffer stocks—commodity reserve area is murky and half-charted at best. The author makes a good case for a commodity reserve proposal as against buffer stocks or commodity agreements, but he does not really show that any of these would be of major consequence.

This book is a clear, carefully reasoned, and undogmatic study of a problem important not only in its own right but as a case study in our frequent failure to mesh our domestic and foreign policies.

C. ADDISON HICKMAN